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In The

Supreme Court of the United States

October Term, 1994

MINNESOTA COMMISSIONER OF REVENUE
AND THE STATE OF MINNESOTA,

Petitioners,

v.

NORWEST BANK DULUTH, N.A.,

Respondent.

MINNESOTA COMMISSIONER OF REVENUE,

Petitioner,

v.

CAMBRIDGE STATE BANK, *et al.*,

Respondents.

Petition For Writ Of Certiorari
To The Minnesota Supreme Court

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

On remand from this Court, the Minnesota Supreme Court decided that it was required under *Harper v. Virginia Dept. of Taxation*, 113 S. Ct. 2510 (1993), to order full refunds of taxes paid by respondent banks on income from federal obligations for periods preceding this Court's decision in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983). In two earlier decisions, the Minnesota Supreme Court denied refunds on several grounds, including respondent banks' failure to use a Minnesota Tax Court appeal procedure in which they could have challenged the tax prior to payment. In the decision sought to be reviewed, the Minnesota Supreme Court held that at the time these taxes were paid, an unresolved issue regarding the tax court's jurisdiction rendered this predeprivation remedy inadequate, and the banks are therefore entitled to refunds. The questions presented are:

1. Whether under this Court's due process holding in *Harper*, a state's predeprivation process is not meaningful because at the time the taxes were paid there was an unresolved issue as to an administrative tax court's jurisdiction to consider constitutional claims;

2. Whether this Court's due process holding in *Harper* requires a state which does not provide a meaningful predeprivation process to provide clear and certain backward-looking relief even when it is clear that taxes were voluntarily paid; and

3. Whether this Court's due process holding in *Harper* prevents a state from raising procedural bars to actions for refunds when its predeprivation process is uncertain.

LIST OF PARTIES

The parties to the proceedings in the Minnesota Supreme Court were: (1) Petitioners Minnesota Commissioner of Revenue (the current Minnesota Commissioner of Revenue is Morris L. Anderson), Minnesota Department of Revenue, and the State of Minnesota; and (2) Respondents Norwest Bank Duluth, N.A., Cambridge State Bank, First Security State Bank of Sleepy Eye, and Midway National Bank of St. Paul.

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PETITION FOR WRIT OF CERTIORARI

The petitioners respectfully request that a writ of certiorari issue to review the judgment of the Minnesota Supreme Court entered in the above-entitled proceeding.

OPINION BELOW

The opinion of the Minnesota Supreme Court is reported at 514 N.W.2d 565 and is reprinted in the appendix at App. 1. Two earlier opinions of the Minnesota Supreme Court are reported at 480 N.W.2d 647 and 457 N.W.2d 716, and are reproduced at App. 19 and App. 37. The most recent opinion was issued upon remand from this Court for reconsideration in light of *Harper v. Virginia Dept. of Taxation,* 113 S. Ct. 2510 (1993). This Court's order vacating the judgment of the Minnesota Supreme Court and remanding the case for reconsideration in light of *Harper* appears at 113 S. Ct. 3026 (1993). App. 18. The Minnesota Supreme Court's second decision was issued upon reconsideration of the case in light of *James B. Beam Distilling Co. v. Georgia,* 111 S. Ct. 2439 (1991), after remand from this Court. That remand order appears at 111 S. Ct. 2881.

JURISDICTION

The opinion of the Minnesota Supreme Court was issued April 1, 1994. A petition for rehearing was denied by order dated May 16, 1994, which is reprinted in the appendix hereto at App. 90. The judgment of the Minnesota Supreme Court was entered on May 24, 1994, and is reprinted in the Appendix at App. 92. Jurisdiction to review the judgment by writ of certiorari is granted by 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The United States Constitution article VI, clause 2 (the "Supremacy Clause"), provides in relevant part:

> This Constitution, and the laws of the United States which shall be made in pursuance thereof, . . . shall be the supreme law of the land,

> and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding.

The United States Constitution amendment XIV, § 1 (the "Due Process Clause"), provides in relevant part:

> nor shall any state deprive any person of . . . property without due process of law. . . .

During the 1979 tax year at issue, Rev. Stat. § 3701, then set forth at 31 U.S.C. § 742 (1959), provided as follows:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

This statute is now codified, with minor amendments not effecting a substantive change in the law, at 31 U.S.C. § 3124(a) (1982).

During the 1979 tax year at issue, Minnesota law provided that orders of the Commissioner of Revenue assessing taxes were appealable to the Minnesota Tax Court, an executive branch administrative body, pursuant to Minn. Stat. § 271.06, subd. 1 (1978). App. 100. Prepayment of taxes in dispute was not required in order to appeal a tax assessment under Minn. Stat. § 271.09, subd. 3 (1978). App. 102. Decisions of the tax court were reviewable by the Minnesota Supreme Court, pursuant to Minn. Stat. § 271.10, subd. 1 (1978). App. 102.

During 1983, the year respondents filed claims seeking refunds of bank excise tax, the procedures for claiming refunds were prescribed by Minn. Stat. § 290.50 (1982 & Supp. 1983). App. 106.

During the 1979-84 time period, Minnesota income tax regulations also provided for an administrative protest and appeal procedure before Department of Revenue officials, culminating in a hearing before the Commissioner. Minn. Rules pts. 8052.0100-.0200 (repealed 1990). App. 103-05. These regulations also applied to corporate franchise and excise taxes.

STATEMENT OF THE CASE

For more than fifty years Minnesota has had a bank excise tax which has included interest income on federal obligations in its net income measure. Minn. Stat. § 290.361 (1978). Before 1983, however, the interest on two types of state bonds was excluded from gross income for the purpose of computing the excise tax. An exemption for revenue bonds issued by the Minnesota State University System (SUBs) for construction of dormitories and other college buildings was enacted in 1957. Minn. Stat. § 136.32 (1978). App. 97. An exemption for industrial development bonds (IDBs) was enacted in 1967. Minn. Stat. § 474.12 (Supp. 1979). App. 98.[1]

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[1] The trial court found that interest earned on obligations of twelve other state and local agencies was also exempt from inclusion in the bank tax. This is incorrect. The exemption language pertaining to bonds (other than SUBs and IDBs) was insufficient to exempt them from franchise taxes as opposed to income taxes. Numerous bond counsel opinions to that effect were stipulated to in the case. The Minnesota Supreme Court did not reach the issue whether these other bonds were also exempt since the Commissioner conceded the exempt status of

During the years in which the two exemptions were in effect prior to their repeal in 1983, neither respondent banks nor any other taxpayer challenged the bank tax as discriminatory against U.S. obligations.[2]

In 1983 this Court issued its opinion in *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983), which held a Tennessee bank tax which taxed U.S. obligation interest but exempted interest on over 70 types of state and local obligations to be a discriminatory tax in violation of 31 U.S.C. § 742 (1959) (now codified as 31 U.S.C. § 3124(a) (1982)). The Minnesota Legislature promptly repealed the IDB and SUB exemptions in 1983, thus removing any conceivable discrimination against federal obligations.

Later in 1983 the respondent banks and virtually all of the more than 700 banks in Minnesota began filing refund claims for bank taxes paid as far back as 1979, citing the *Memphis Bank* opinion.

In its initial decision issued on July 20, 1990, the Minnesota Supreme Court found that the bank tax was discriminatory. The court denied refunds, however, on three separate grounds. First, the court held that the banks, being large holders of IDBs, had benefited from the bank tax exemption for such bonds and were therefore estopped from challenging the exemptions under *Gale v. Commissioner of Taxation,* 37 N.W.2d 711 (Minn. 1949).

Second, the court ruled that the appropriate remedy under Minnesota law was severance of the offending

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SUBs and IDBs, which was sufficient to present the discrimination issue for the court. *See* 457 N.W.2d at 718 n.2, App. 40 n.2

[2] Taxes were paid by the respondent banks without objection for the 1979-1983 tax years for which they later claimed refunds. As to the 1979 tax year – the "test year" stipulated by the parties for purposes of this action – there was no requirement that taxes be prepaid as a condition of challenging them.

state bond exemptions. The Minnesota high court found that it would, if compelled, actually impose a retroactive tax on state bond interest income. The court declined to impose such a requirement, however, because collection would unfairly penalize both the respondent banks, as owners of exempt bonds, and the state for failing to foresee that Minnesota's tax exemptions would be unlawful under *Memphis Bank*. The court also said that imposing retroactive taxation to level the playing field was not required since the state bond exemptions resulted in no adverse comparative economic impact on respondents vis-a-vis their competitors.[3] Furthermore, the court noted that in this federal obligation immunity case, actually undoing any damage to the federal borrowing power by state policy during the years in question is impossible.

As a third ground for denying refunds, the Minnesota high court found that the *Memphis Bank* case should apply prospectively only. In reaching this conclusion, the court applied the three-part prospectivity analysis of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). Under the *Chevron* criteria, the court found that: 1) *Memphis Bank* was not clearly foreshadowed; 2) the purposes of federal tax immunity would not be furthered by retroactive application; and 3) retroactive application of *Memphis Bank* would produce substantially inequitable results.

Respondents filed a petition for writ of certiorari with this Court requesting review of the Minnesota Supreme Court's decision. While the petition was pending, the Court decided *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991). This Court then granted the petition, vacated the judgment of the Minnesota

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[3] Indeed, all banks which purchased state bonds – including respondents – received the benefit of tax exempt interest income therefrom.

Supreme Court, and remanded the case to the Minnesota court for further consideration in light of *Beam*.

On remand, the Minnesota Supreme Court reversed its original holding on prospectivity and held that the *Beam* decision requires retroactive application of the substantive rule of federal law established in *Memphis Bank*. However, the court reaffirmed the independent state law grounds for its earlier decision not to award refunds. The court noted that the *Beam* decision preserves the state's right to raise procedural bars to an otherwise required retroactive application of a federal rule of law. *Beam* also affirmed the state's right to fashion an appropriate remedy where the case originated in state court. The court found the estoppel holding to be a state procedural bar to recovery of refunds as contemplated under *Beam*. The court also held that minimum constitutional due process requirements were met by the fact that, for the tax years in issue, Minnesota law did not require prepayment of a tax in order to challenge the validity of the tax. Thus, there were sufficient procedural safeguards, which respondent banks failed to use, against unlawful exaction of the tax at the time it was assessed.

As to the court's remaining severance holding, the court again based its denial of refunds on the sufficiency of severance as a remedy for the discrimination caused by the tax. The court noted that when the legislature first enacted the bank tax, there were no state obligation tax exemptions; accordingly, the later exemptions (which caused the defect in the tax) could not be said to have invalidated the entire original act.[4]

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[4] The court noted that under these circumstances, severance was mandated by Minnesota's severance statute, Minn. Stat. § 645.20 (1988). App. 34, 47.

In addition, the court again noted that the tax had not placed respondents at an actual comparative economic disadvantage. Accordingly, neither actual imposition of a corrective tax nor a refund of taxes paid was required.

Respondent banks again filed a petition for writ of certiorari with this Court. While this petition was pending, the Court decided *Harper v. Virginia Dept. of Taxation,* 113 S. Ct. 2510 (1993). The Court granted the petition, vacated the judgment, and again remanded the case to the Minnesota Supreme Court, this time for further consideration in light of *Harper.*

On second remand, without oral argument, the Minnesota Supreme Court reversed its previous holding as to remedies and held that respondent banks were entitled to a refund of taxes paid on income from federal obligations. Reconsidering its two prior decisions in light of *Harper,* the Minnesota Supreme Court concluded that "after *Harper* the existence of a meaningful predeprivation remedy is a necessary precondition to denying a retroactive remedy on any state law theory." *Cambridge State Bank v. James,* 514 N.W.2d 565, 569. App. 9.[5] Upon reconsideration, the Minnesota court reversed its earlier conclusion in this case that there was a predeprivation procedure in place in Minnesota during the tax year in issue which satisfied the federal due process standards set out in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco,* 496 U.S. 18 (1990).

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[5] Contrary to the court's assertion, the petitioners did not "agree" that such a remedy was a necessary precondition to denying refunds. The Commissioner merely argued that a meaningful predeprivation process was clearly available and that minimum federal constitutional thresholds had therefore been satisfied under *Harper,* obviating the need for postdeprivation relief.

Based upon the fact that before 1984, the issue of whether the Minnesota Tax Court had jurisdiction to decide constitutional issues was "unsettled", the Minnesota Supreme Court stated that it did not think that the tax court prepayment appeal mechanism provided the "meaningful opportunity" called for by *McKesson*.[6] Having thus concluded that Minnesota did not provide a meaningful predeprivation remedy in 1980 (when 1979 taxes were paid), the court ordered a refund of taxes, rejecting what it saw as the alternative remedies of a retroactive tax on exempted state obligation income or some combination of refunds and retroactive compensating tax.[7]

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[6] The court assumed that it was required to decide what remedies were hypothetically available to the banks in 1980, because that was the year during which taxes due for the test year of 1979 were paid. Nothing in the record, however, suggests that respondent banks even considered challenging the franchise tax until this Court's 1983 decision in *Memphis Bank*.

[7] The Minnesota Supreme Court had initially refused to impose a retroactive tax on state obligations because it believed that to do so would be unfair to both parties. *Cambridge State Bank v. Roemer*, 457 N.W.2d 716, 722. App. 49. In again rejecting this alternative to full refunds, the court noted the "possible difficulties inherent in collecting a retroactive tax" and the fact that "the United States Supreme Court has not spoken clearly with regard to the constitutionality of a retroactive tax." *Cambridge State Bank v. James*, 514 N.W.2d at 571. App. 16. This Court's decision in *Carlton v. United States*, 114 S. Ct. 2018 (1994), calls into question this conclusion of the Minnesota Supreme Court.

REASONS FOR GRANTING THE WRIT

I. CERTIORARI SHOULD BE GRANTED TO RESOLVE WHAT TYPE OF PREDEPRIVATION RELIEF IS REQUIRED FOR A STATE TO BE ABLE TO EXTINGUISH ANY POSTDEPRIVATION OBLIGATION TO REFUND TAXES.

This case presents another opportunity for the Court to resolve an issue presented in some form in four cases decided by the Court in the past four years: *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco,* 496 U.S. 18 (1990); *American Trucking Ass'ns, Inc. v. Smith,* 496 U.S. 167 (1990); *James B. Beam Distilling Co. v. Georgia,* 111 S. Ct. 2439 (1991); and *Harper v. Virginia Dept. of Taxation,* 113 S. Ct. 2510 (1993). The issue is to what extent the Due Process Clause of the United States Constitution requires states to refund taxes alleged by a taxpayer to be unconstitutional.

This Court has stated clearly in two of those recent decisions that if a state offers taxpayers a meaningful opportunity to challenge a tax assessment prior to payment, this procedural safeguard is "sufficient by itself to satisfy the Due Process Clause." *Harper,* 113 S. Ct. at 2519; *McKesson,* 496 U.S. at 38 n.21. This statement by the Court recognizes the states' need to rely on revenues collected in good faith under presumptively valid tax laws. Otherwise, tax revenues are collected only conditionally, and states are exposed to the constant threat of fiscal disruption. As this Court has acknowledged, states may avoid that threat by establishing adequate predeprivation remedies for taxpayers to challenge tax assessments they believe to be invalid.

The question remains, however, a to what constitutes a "meaningful opportunity" to challenge a tax assessment prior to payment. In reality, that option does not exist for

states if predeprivation remedies must meet an unrealistic due process standard that exposes taxpayers to no risks or uncertainties and that is impossible for states to satisfy.

On February 22, 1994, this Court granted certiorari in *Reich v. Collins*, 437 S.E.2d 320 (1993), *cert. granted*, 114 S. Ct. 1048 (1994) (No. 93-908), to decide whether predeprivation procedures to dispute state income taxes under Georgia law satisfy federal due process requirements. A variation of the same issue is presented by this case.

Like the instant case, *Reich v. Collins* was remanded by the United States Supreme Court for reconsideration in light of *Harper v. Virginia Dept. of Taxation*, 113 S. Ct. 2510 (1993). On remand, the Georgia Supreme Court decided that declaratory judgment and injunctive relief remedies available under Georgia law provided meaningful opportunities to taxpayers to litigate the validity of taxes prior to the time when the taxes fell due. In contrast, in the instant case the Minnesota Supreme Court held that, even though Minnesota law provided for prepayment tax court appeals from assessment orders, uncertainties as to that court's jurisdiction to resolve constitutional issues rendered that remedy insufficiently meaningful for due process purposes. Thus, *Reich v. Collins* and this case represent the flip sides of the same issue. Certiorari should be granted in this case as it was in *Reich v. Collins*, to further clarify issues unresolved by *Beam* and *Harper*. If certiorari is not granted immediately, consideration of this petition should be deferred until *Reich* is decided to ensure that the outcome in the instant

case is consistent with the Court's resolution of the Georgia case.[8]

II. CERTIORARI SHOULD BE GRANTED BECAUSE THE MINNESOTA SUPREME COURT MISCONSTRUED *HARPER* AND *MCKESSON* TO REQUIRE PROCEDURAL CERTAINTY IN PREDEPRIVATION REMEDIES, RATHER THAN A MEANINGFUL OPPORTUNITY TO WITHHOLD CONTESTED TAX PAYMENTS AND TO CHALLENGE THEIR VALIDITY IN A PREDEPRIVATION HEARING.

This Court's decisions clearly establish that a state may satisfy its constitutional due process obligation to provide taxpayers with adequate procedural safeguards in two ways – through a predeprivation process *or* through a postdeprivation process. Federal due process does not require states to provide both; an adequate predeprivation process alone is sufficient. *Harper,* 113 S. Ct. at 2519; *McKesson,* 496 U.S. at 38 n.21. The choice of whether to provide pre- or postdeprivation due process is left to the states.

In *McKesson,* a unanimous Court said that the provision of a prepayment opportunity to object to a tax obviated any due process obligation to provide a postpayment remedy. The Court stated:

> [I]f a State chooses not to secure payments under duress and instead offers a meaningful opportunity for taxpayers to withhold contested tax assessments and to challenge their validity

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[8] This Court has on occasion held a petition for certiorari until a decision is reached in a pending case raising similar issues. *See, e.g., Keney v. New York,* 388 U.S. 440 (1967) (petition held nearly two and a half years until decisions were rendered in other obscenity cases).

> in a predeprivation hearing, payments tendered may be deemed "voluntary." The availability of a predeprivation hearing constitutes a procedural safeguard against unlawful deprivations sufficient by itself to satisfy the Due Process Clause, and taxpayers cannot complain if they fail to avail themselves of this procedure. See *Mississippi Tax Comm'n, supra,* 412 U.S., at 368, n.11, 93 S. Ct. at 2187, n.11 ("[W]here voluntary payment [of a tax] is knowingly made pursuant to an illegal demand, recovery of that payment may be denied").

McKesson, 496 U.S. at 38 n.21.

After *McKesson* and *Harper,* the remaining question, presented in this case and in *Reich v. Collins,* is what type of predeprivation process satisfies the minimum demands of federal due process in state tax cases. This question is a federal issue. While states are free to establish their own remedial procedures, "federal law sets certain minimum requirements." *American Trucking Ass'ns, Inc. v. Smith,* 496 U.S. at 178-79. Thus, this Court should grant certiorari in this case, as it has in *Reich v. Collins,* to decide what type of state procedures afford the meaningful opportunity to withhold contested tax assessments and to challenge them in a predeprivation hearing which is permitted under *McKesson* and *Harper* as an alternative to a "clear and certain" postdeprivation remedy.

A. Minnesota Provides Taxpayers With A Meaningful Opportunity To Withhold Payment And Obtain A Predeprivation Determination Of A Tax Assessment's Validity.

Taxpayers in Minnesota are entitled to challenge a tax assessment in a prepayment appeal to the Minnesota Tax Court in a procedure set forth in Minn. Stat. § 271.06

(1978). App. 100. The tax court was created in its present form as a specialized administrative court in 1977 by the Minnesota Legislature. *See* Act of May 27, 1977, ch. 307, 1977 Minn. Laws 606-19. The tax court has broad jurisdiction to hear and determine "all questions of law and fact arising under the tax laws of the state," pursuant to Minn. Stat. § 271.01, subd. 5 (1978). App. 99. An appeal may be taken to the tax court without prior payment of any amounts in dispute, under Minn. Stat. § 271.09, subd. 3 (1978). App. 102. Tax court decisions are reviewable as a matter of right upon certiorari by the Minnesota Supreme Court. Minn. Stat. § 271.10 (1978). App. 102. There can be no doubt that this procedure satisfies minimum requirements of due process for a meaningful opportunity to object in advance to the payment of a tax. *Cf. Mathews v. Eldridge*, 424 U.S. 319 (1976); *Goldberg v. Kelly*, 397 U.S. 254 (1970).

In its second decision in this case, the Minnesota Supreme Court expressly held that the tax court appeal process was a form of predeprivation remedy which satisfied the federal due process standards set forth in *McKesson*. In its most recent opinion, however, the Minnesota Supreme Court changed its position, concluding that there was some uncertainty about the tax court's jurisdiction over constitutional issues during 1980 (the year immediately following the tax year at issue). This "uncertainty," coupled with the existence of a statutory refund procedure in Minn. Stat. § 290.50 (1980), led the court to state "[W]e cannot assert that the meaningful predeprivation remedy required by *McKesson* existed in early to mid-1980." *Cambridge State Bank v. James*, 514 N.W.2d 565, 570. App. 12.

The Minnesota Supreme Court based its conclusion that there was some uncertainty in the tax court's constitutional jurisdiction on three cases. First, the court noted

that in a footnote in *Harris v. Commissioner of Revenue*, 257 N.W.2d 568 (Minn. 1977), it mentioned that the tax court's jurisdiction to hear a constitutional challenge to state statutes had not been challenged by either party. *Id.* at 569 n.1. Thus, even though in *Harris* the Minnesota Supreme Court upheld the tax court's ruling on the constitutionality of a statute and stated further that its decision intended no comment on the scope of authority of the tax court, the Court concluded that the *Harris* decision "called into question the tax court's jurisdiction over constitutional issues." *Cambridge*, 514 N.W.2d at 570. App. 12.

In the second case, decided in September, 1980, the Minnesota Supreme Court held that the tax court did not have original jurisdiction over constitutional issues, but that it could consider such claims upon transfer from state district court, a judicial court of general jurisdiction. *In re McCannel*, 301 N.W.2d 910, 919 (Minn. 1980).

Finally, in 1984, the Minnesota Supreme Court ratified a procedure already in use, whereby the tax court could obtain jurisdiction over constitutional issues by the simple expedient of transferring a case which had initially been filed in the tax court to state district court and having the district court transfer the case, replete with constitutional jurisdiction, back to the tax court for decision on the merits of all issues. *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261, 264 (Minn. 1984). Based on these cases, the *Cambridge* court stated: "With this history in mind, the existence of some avenue for challenging the tax before paying 1979 taxes in early to mid-1980 can be asserted, but only with hindsight." *Cambridge*, 514 N.W.2d at 570. App. 12.[9]

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[9] In so concluding, the court expressly discounted the fact that during this period of "uncertainty," both it and the tax

Assuming the Minnesota Supreme Court is correct that these cases show that there was some uncertainty as to the extent of the tax court's jurisdiction during 1980, the question remains whether the tax court appeal mechanism was thereby rendered so fatally flawed as to effectively deprive taxpayers of the "meaningful remedy" called for by *McKesson*, particularly in light of other prepayment remedies which were also available.[10] This Court should grant certiorari to decide that issue.

B. The Minnesota Supreme Court Applied A Standard Of Certainty In Predeprivation Procedures Which Is Not Required By Prior Decisions Of This Court.

Under the standard applied by the Minnesota Supreme Court, any risk or uncertainty in predeprivation

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court continued to hear and decide constitutional issues initially raised in tax court, thus clearly indicating that no "hindsight" was required to find an "avenue" for prepayment challenges. *See, e.g., Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138, 139 n.1 (Minn. 1980); *Nagaraja v. Commissioner of Revenue*, 352 N.W.2d 373 (Minn. 1984) (transfer procedure used in 1982 to confer constitutional jurisdiction on tax court in appeal filed in 1981). At no time during this period did the Minnesota Supreme Court reject on jurisdictional grounds a constitutional issue that had been raised in the first instance in a tax court proceeding.

[10] Quite aside from the tax court appeal procedure, the Minnesota court ignored the possible declaratory judgment remedies available to taxpayers. *See infra*, note 13. Minnesota also offered taxpayers an informal hearing process to appeal tax assessments by the filing of a protest and a subsequent hearing before a department of revenue representative, with the right to request a second hearing before the commissioner with respect to the same issues. Minn. Rules pt. 8052.0100-.0200 (repealed 1990). App. 103-05. A similar administrative appeals procedure was codified at Minn. Stat. § 289A.65 (1990).

remedies, however slight, may render them not "meaningful" and therefore inadequate to meet minimum federal due process requirements.[11] The Minnesota court decided that the remedy provided by Minn. Stat. § 271.06 (1978) was "meaningless" during 1980 because of an unresolved issue regarding tax court jurisdiction. The court's decision centers on its apparent belief that due process is not satisfied if any doubt can be raised regarding the scope of the prepayment procedure. The court missed the point. There is no support for such a due process standard. The issue under *McKesson* is whether a taxpayer may *be heard* prior to payment of the tax. Taxpayers clearly may obtain such relief in Minnesota.

Procedural due process is founded on notions of fundamental fairness. *Wolff v. McDonnell*, 418 U.S. 539 (1974). It is not a concept to be determined formalistically; rather, the specific dictates of due process vary with each factual situation. *Board of Curators v. Horowitz*, 435 U.S. 78, 87 n.3 (1978) (due process requirements depend on analysis of all relevant factors); *Cafeteria Workers v. McElroy*, 367 U.S. 886, 895 (1961) (very nature of due process negates any concept of inflexible procedures universally applicable to every situation). Once it is determined that due process applies, the question remains what process is due under the circumstances. *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972). *See also Goss v. Lopez*, 419 U.S. 565, 577-78 (1975) (interpretation and

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[11] Like the petitioner in *Reich v. Collins*, respondent banks also alleged on remand that Minnesota secures payments under duress because of penalties and interest which may accrue on unpaid tax liabilities. The Minnesota Supreme Court did not reach that issue because of its holding that refunds are required due to the lack of a meaningful predeprivation remedy. Therefore, the duress issue is not presented in this petition.

application of the Due Process Clause are intensely practical matters). Thus, determining whether a state's predeprivation process satisfies the requirements of due process "will depend upon appropriate accommodation of the competing interests involved." *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 434 (1982) (quoting *Goss*, 419 U.S. at 579). These competing interests include private interests on one hand and, on the other, "the government's interest, including the function involved and the fiscal and administrative burdens that additional or substitute procedural requirements would entail." *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976).

Generally, since *Mathews*, the federal courts have engaged in a balancing of specific interests to determine whether a predeprivation remedy is required, and whether the remedy is adequate. *McKesson* expressly acknowledged the applicability of this balancing approach in determining the extent of a state's obligation to provide procedures for taxpayers to obtain relief. 496 U.S. at 50 ("[W]ithin our due process jurisprudence, state interests traditionally have played, and may play, some role in shaping the contours of the relief that the state must provide to illegally or erroneously deprived taxpayers").

In the instant case, the governmental interest to be weighed is the ability of the State of Minnesota to include within its tax collection, enforcement and refund system reasonable predeprivation procedures without being held to standards which are unrealistic or which exceed constitutional requirements. The fact that a predeprivation hearing and appeal procedure contains some inherent risk that the taxpayer may not prevail in his challenge or that a taxpayer must make decisions regarding which of several procedures to use cannot result in the procedures themselves not being meaningful. A procedure is meaningful under due process if it provides a fair opportunity

to be heard. Minnesota law provided respondent banks with ample opportunities to be heard prior to payment.

The creation of a special tax court to hear appeals from "any official order of the commissioner of revenue respecting any tax, fee, or assessment, or any matter pertaining thereto, including the imposition of interest and penalty," is at least sufficient to provide the "meaningful opportunity" required by federal due process. It is hard to imagine a more "meaningful opportunity" than the right to appeal such an order to a body with express authority "for the hearing and determination of all questions of law and fact arising under the tax laws of the state." Minn. Stat. § 271.01, subd. 5 (1978). App. 99. The tax court is further authorized "to review and redetermine orders or decisions of the commissioner of revenue upon appeal therefrom in the cases authorized by law." Minn. Stat. § 271.05 (1978). App. 100. Such review is in the form of a trial de novo at a public hearing, in which all parties "shall have an opportunity to offer evidence and arguments." Minn. Stat. § 271.06, subd. 6 (1978). App. 100. In such cases, when an appeal has been taken from an order or determination of the commissioner, "the proceeding shall be an original proceeding in the nature of a suit to set aside or modify the order or determination." *Id.* At the end of the review process, "in all cases the decision of the tax court upon appeal, or the Supreme Court upon review, as the case may be, shall stand in lieu of the order of the commissioner . . . from which the appeal was taken." Minn. Stat. § 271.09, subd. 1 (1978).

There clearly is nothing in this statutory scheme which indicates that respondent banks could not have brought their claims using the state's predeprivation procedures. The only uncertainty the Minnesota court could point to that existed when these taxes were paid was a footnote in the *Harris* case which mentioned a jurisdictional issue that had not been raised or decided. Thus, the

Minnesota court's decision raises the serious and substantial question whether the existence of any uncertainty, no matter how speculative, as to whether a specific claim can be adjudicated in a particular tribunal constitutes a denial of due process. The Minnesota decision indicates that absolute certainty in such matters is required in order to satisfy federal due process, even where there are comprehensive statutory predeprivation procedures in place. Nothing in this Court's prior decisions indicates that this degree of certainty is required in predeprivation hearing procedures. If that is to be the due process standard in tax cases, it should be clearly articulated by this Court so the states may plan accordingly.

Petitioners believe that the tax court appeal and other options available in Minnesota provided taxpayers a full and complete remedy, all without first paying the tax. Of equal importance, an objection to a tax either in the form of a tax court appeal or an administrative protest, which was also available under Minnesota income tax regulations during the period in question, puts the state on notice before the payment of a tax that its legality is contested.[12] It is not appropriate for respondent banks to have withheld their objections, if any, paid the tax, and then attempt to obtain a refund in 1983 only after the Minnesota Legislature repealed tax exemptions for state bonds which respondents had taken advantage of for many years.

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[12] The income tax regulation permitting taxpayers to protest a proposed tax assessment before the department of revenue and to appeal in a hearing to the commissioner was promulgated in 1939 as Article 50-2 of the Minnesota Income and Franchise Tax Regulations. It was later recodified, first as MCAR § 2052(2) and finally as Minn. Rules pt. 8052.0100 (repealed 1990). The rule was repealed when similar procedures were codified in statute. Minn. Stat. § 289A.65 (1990).

Respondent banks had a clear, meaningful, prepayment opportunity to challenge the validity of the tax of which they now complain. They chose not to avail themselves of this or any other remedy.[13] It follows under *McKesson* that they must be considered to have paid the challenged taxes voluntarily. Most importantly, *McKesson* makes it clear that due process does not require an additional postpayment refund remedy in order to provide respondents the relief they could have obtained in advance of paying the tax.

III. THE COURT SHOULD GRANT CERTIORARI TO DECIDE WHETHER FEDERAL LAW REQUIRES STATES THAT DO NOT PROVIDE ADEQUATE PREDEPRIVATION PROCEDURES TO PROVIDE REFUNDS OF ILLEGALLY ASSESSED TAXES EVEN IF THE TAXES WERE VOLUNTARILY PAID.

The Minnesota court construed federal due process to require postdeprivation relief in a case where it is clear that tax payments were made voluntarily. This Court's decisions indicate that under circumstances where payment of taxes is voluntary, recovery of such payment may be denied. Thus, even if the Minnesota Supreme Court is correct that jurisdictional uncertainty rendered Minnesota's predeprivation remedies inadequate for federal

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[13] Ironically, not 90 days after its decision in the instant case, the Minnesota Supreme Court held that Minnesota taxpayers like respondents with a facial constitutional challenge to a tax statute have yet *another* predeprivation remedy in the form of a declaratory judgment action in state district court, notwithstanding a state tax anti-injunction provision. *Baertsch v. Minnesota Dept. of Revenue*, 518 N.W.2d 21 (Minn. 1994). Thus, respondents had at least three predeprivation remedies available to them, all of which they ignored.

due process purposes, it does not follow that a post-deprivation remedy consisting of refunds is required.

In *United States v. Mississippi Tax Comm'n*, 412 U.S. 363, 368 n.11 (1973), this Court stated, "[W]here voluntary payment [of a tax] is knowingly made pursuant to an illegal demand, recovery of that payment may be denied." On this basis the *McKesson* Court stated that tax payments tendered may be deemed "voluntary" if a state offers a meaningful predeprivation hearing of which taxpayers fail to avail themselves. *McKesson* did not say, however, this is the *only* circumstance under which payment of a tax may be considered to be "voluntary," such the recovery of that payment may be denied. There are circumstances where payment of a tax is so clearly voluntary that the existence or not of an adequate predeprivation remedy is irrelevant.[14] In some situations, a taxpayer simply would not have availed himself of a meaningful opportunity to challenge the validity of a tax assessment even if that opportunity had been offered. This is such a case.

The State of Minnesota enacted tax exemptions for certain state bonds which excluded income from those obligations from the measure of corporate franchise taxes as long ago as 1957. *See* Act of April 24, 1957, ch. 603, § 2, 1957 Minn. Laws 753 (codified at Minn. Stat. § 136.32 (1978)). App. 97. Yet for more than 25 years, Minnesota

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[14] The cases cited in *United States v. Mississippi Tax Comm'n*, 412 U.S. at 368 n.11, indicate that a tax payment is voluntary whenever it is not made under duress, which is shown only when a taxpayer "can save himself and his property in no other way than by paying the illegal demand. . . ." *Little v. Bowers*, 134 U.S. 547, 554 (1890). This line of cases involved application of the common law rule that taxes voluntarily paid cannot be recovered, and not procedural due process issues. Nevertheless, voluntary payment is clearly a factor in determining what process is due under *McKesson*.

banks continued without challenge to pay excise taxes which included within the measure of the tax income from federal obligations, while excluding income from certain state obligations (SUBs and, after 1967, IDBs). Not only did hundreds of Minnesota banks pay the franchise tax when due; during the entire period from 1957-1983, not one bank filed a refund claim based on an alleged violation of 31 U.S.C. § 3124(a). Only after this Court's decision in *Memphis Bank & Trust Co. v. Garner* and after it was clear the Minnesota Legislature was taking steps to repeal the offending state bond exemptions did hundreds of Minnesota banks file refund claims.

There are only two credible explanations for the banks' delay in challenging the bank franchise tax: either they did not believe the tax illegally discriminated against federal obligations, or they made a calculated decision not to challenge the tax in spite of the discrimination. In either case, the availability of predeprivation remedies was not a factor, and the payments were voluntary.

To the extent the banks may have suspected the tax was discriminatory, they of course had a strong incentive not to force the issue prior to the *Memphis Bank* decision. As heavy investors in state obligations, the banks continued to benefit form the exclusion of income derived therefrom from their tax base.[15] It would have been obvious to any bank contemplating a challenge that the probable result of a decision invalidating the bank tax was the repeal of the offending – and to these taxpayers, desirable – state bond exemptions, rather than enactment of a similar exemption for federal obligation income.

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[15] Thus, the respondent banks actually paid lower taxes before repeal of the discriminatory state bond exemptions than they paid after the discrimination against federal obligations ended. *Cambridge State Bank v. Roemer*, 457 N.W.2d 716, 723. App. 51-52.

Indeed, that is exactly what happened in the aftermath of the *Memphis Bank* decision.

Under these circumstances, the availability of a predeprivation remedy played no role in the banks' decision whether to pay the taxes due for 1979, the test year in this case. If it had, they would have claimed a refund for that year immediately after paying the tax, instead of waiting until 1983 to do so.

Given the banks' clear lack of interest in challenging the bank franchise tax until after *Memphis Bank* had been decided, it is manifestly unjust to base an entitlement to refunds on uncertainties in tax court jurisdiction during 1980. It strains credibility to assert that the banks were in any way deterred from pursuing a predeprivation remedy by a lack of certainty in tax court procedure or jurisdiction.[16]

Indeed, there is an unmistakable odor of unreality about the entire inquiry as to what predeprivation remedies were available under Minnesota law during the 1979-80 time period. No one will ever know what might have happened had the banks attempted to use one of the predeprivation procedures that were available, because they never bothered to try. It is apparent that, even if the tax court's jurisdiction to hear and decide constitutional issues was crystal clear throughout the 1979-1983 period, respondent banks would not have pursued their claims in that or any other forum.

Under these circumstances, it is absurd to conclude that the state must pay millions of dollars in bank tax

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[16] The banks have never claimed that they would have pursued their challenge in tax court during 1979-80 but for the uncertainty in tax court jurisdiction. Moreover, even if that "uncertainty" existed, there were alternative remedies. As is clear from the record, respondent banks attempted no action of any kind to contest the validity of the tax prior to assessment or payment.

refunds because of unresolved issues in tax court jurisdiction at the time the taxes were paid.[17] Rather, payments tendered by the respondent banks should be deemed "voluntary," because that is what they were.[18] "[W]here voluntary payment [of a tax] is knowingly made pursuant to an illegal demand, recovery of that payment may be denied." *McKesson*, 496 U.S. at 38 n.21 (quoting *United States v. Mississippi Tax Comm'n*, 412 U.S. at 368 n.11).

IV. THE COURT SHOULD GRANT CERTIORARI TO DECIDE WHETHER STATE PROCEDURAL BARS TO TAX REFUND CLAIMS MAY PRECLUDE RECOVERY OF REFUNDS EVEN IF NO MEANINGFUL PREDEPRIVATION PROCESS IS AVAILABLE.

The decision of the Minnesota court held that a state law procedural bar to refund actions cannot be raised if there was no meaningful predeprivation procedure available when the tax was paid. This holding directly conflicts with prior statements of this Court in *McKesson* and *Beam* regarding that issue.

In its first two decisions in this case, the Minnesota Supreme Court held that, under a well-established line of Minnesota cases, respondent banks were estopped from asserting the unconstitutionality of the Minnesota bank tax. *Cambridge State Bank v. Roemer*, 457 N.W.2d 716, 720, App. 45-46, *Cambridge State Bank v. James*, 480 N.W.2d 647, 652, App. 26. In its second decision, the court reaffirmed its estoppel holding, concluding that *Beam* allowed states

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[17] The Department of Revenue now estimates that refund claims exceed $230 million in tax and interest.

[18] There is no indication in this Court's decisions that a voluntary payment of taxes, once made, later becomes involuntary simply because at some point the taxpayer changes its mind and decides to challenge the tax.

to raise procedural bars to recovery of taxes paid. The court stated: "We think this court's estoppel holding is one such state procedural bar." *Id.* Yet in its most recent decision, the Minnesota court concluded that "after *Harper* the existence of a meaningful predeprivation remedy is a necessary precondition to denying a retroactive remedy *on any state law theory.*" *Cambridge State Bank v. James,* 514 N.W.2d at 569 (emphasis added). App. 9. This conclusion is clearly incorrect, and unduly restricts the state's options for establishing reasonable procedural restrictions on refund claims even in the absence of predeprivation remedies.

The Supreme Court in *McKesson* recognized "a state's freedom to impose various procedural requirements on actions for postdeprivation relief." 496 U.S. at 45. In a tax refund action, the State of Minnesota may, consistent with the Due Process Clause, require exhaustion of all applicable administrative procedures and claim filing requirements. *See Logan v. Zimmerman Brush Co.,* 455 U.S. at 437 ("the state certainly accords *due* process when it terminates a claim for failure to comply with a reasonable procedural or evidentiary rule") (emphasis in original); *see also McKesson,* 496 U.S. at 45 n.28, *citing Ward v. Love County Bd. of Comm'rs,* 253 U.S. 17, 25 (1920) (recognizing refund claim could be barred if there was "any valid local [limitations] law in force when the claim was filed").

Indeed, the Court in *McKesson* specified that, on remand, "the State may invoke, *as an independent basis for refusing to provide a refund,* petitioner's failure to comply with a notice requirement that was in effect at the time of petitioner's tax payment." 496 U.S. at 24 n.4 (emphasis added). *See also Beam,* 111 S. Ct. at 2448 ("Nothing we say here deprives [the State] of [its] opportunity to raise procedural bars to recovery under state law"). Petitioners are therefore entitled to raise any applicable state law procedural bar as grounds for denial of respondents' refund claims. Unlike the petitioner in *McKesson,* whom

the Court assumed had satisfied whatever procedural requirements might exist, (496 U.S. at 24 n.4) respondents in this case have not done so. Thus, in light of the Court's statements in *McKesson*, denial of plaintiffs' refund claims on estoppel grounds is not only mandated under Minnesota law, but is fully consistent with federal due process principles as well.

That certain taxpayers may be estopped from raising claims challenging the validity of tax schemes is a well-recognized principle under both state and federal law. Minnesota has long applied an acceptance-of-benefits doctrine in tax cases, under which a taxpayer is estopped from assuming the validity of a statute for the purpose of receiving its benefits while also attacking it as unconstitutional, in an attempt to receive even greater rewards. *See Gale v. Commissioner of Taxation*, 37 N.W.2d 711 (Minn. 1949) (taxpayer who claims tax reduction as result of statutory amendment estopped from challenging effective date of amendment). The estoppel doctrine of acceptance of benefits has also been applied in federal cases,[19] as in, for example, *Arnett v. Kennedy*, 416 U.S. 134, 152-53 (1974) (plurality opinion) (court viewed skeptically action of litigant in challenging constitutionality of portions of federal civil service statutes under which he simultaneously claimed benefits); *Magee v. United States*, 282 U.S. 432

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[19] When applied in federal tax cases, the acceptance of benefits doctrine is variously known as the "duty of consistency" or "quasi-estoppel." Under this doctrine, a taxpayer who has received a tax benefit due to treatment of an item in a year barred by the statute of limitations as to an additional assessment is precluded from claiming that the original treatment was incorrect in order to obtain a tax advantage in a later year. *See Beltzer v. United States*, 495 F.2d 211, 212 (8th Cir. 1974); *Unvert v. Commissioner*, 72 T.C. 807 (1979), *aff'd on other grounds*, 656 F.2d 483 (9th Cir. 1981); *Griffith v. Commissioner*, T.C.M. (P-H) ¶ 89,070 (1989); *Coldiron v. Commissioner*, T.C.M. (P-H) ¶ 87,569 (1987).

(1931) (taxpayer who benefited from claim in abatement not in position to challenge its legality); and *Strickland v. Flue-Cured Tobacco Coop. Stabilization Corp.*, 643 F. Supp. 310 (D.S.C. 1986) (rebate beneficiaries of federal tobacco price support program barred under doctrine of constitutional estoppel from attacking the statute authorizing rebates). The Court has also applied estoppel as a matter of federal common law, in order to preserve significant policy interests and prevent unjust results. *D'Oench, Duhme & Co., Inc. v. Federal Deposit Ins. Corp.*, 315 U.S. 447 (1942) (maker of note estopped to assert lack of consideration as defense to suit on note brought by FDIC as insurer of lending bank).

Likewise, under the federal doctrine of constitutional estoppel, this Court has refused to allow litigants to challenge statutes under which they have voluntarily accepted benefits. In *Fahey v. Mallonee*, 332 U.S. 245 (1947), the Court held that "[i]t is an elementary rule of constitutional law that one may not retain the benefits of the act while attacking the constitutionality of one of its important conditions," and that "[t]he court will not pass upon the constitutionality of a statute at the instance of one who has availed himself of its benefits." *Id.* at 255 (citations omitted). *See also Federal Deposit Ins. Corp. v. American Bank Trust Shares, Inc.*, 460 F. Supp. 549 556-57 (D.S.C. 1978) (finding that *Fahey* has not been modified or overruled and holding plaintiffs estopped from contesting constitutionality of statutes), *aff'd on other grounds*, 629 F.2d 951 (4th Cir. 1980).

Moreover, equitable considerations have long been recognized as applicable to the determination of a remedy in tax refund actions. In *Stone v. White*, 301 U.S. 532 (1937), the Court held that an "action, brought to recover a tax erroneously paid, although an action at law, is equitable in its function." 301 U.S. at 534. The Court stated:

> Since, in this type of action, the plaintiff must recover by virtue of a right measured by equitable standards, it follows that it is open to the defendant to show any state of facts which, according to those standards, would deny the right. . . .

Id. at 535 (citations omitted). Thus, use of estoppel doctrines to bar refund claims in tax cases is not a revolutionary idea at either the state or federal level.

Yet the Minnesota Supreme Court concluded that it was prevented by federal due process principles from applying this state law procedural limitation on post-deprivation refund claims. "If there was a meaningful predeprivation procedure in Minnesota at the time the tax was paid, then we have the option of denying backward-looking relief and *state law bars to relief may come into play.*" *Cambridge State Bank v. James*, 514 N.W.2d at 569 (emphasis added). App. 9. However, nothing in *McKesson, Beam* or *Harper* suggests that lack of a meaningful predeprivation process precludes states from imposing reasonable procedural requirements on post-deprivation remedies. Were this so, such basic requirements as filing refund claims within limited statutory time periods would be suspect. To the contrary, the Court in *McKesson* expressly referred to "[a] State's freedom to impose various procedural requirements on actions for postdeprivation relief," including the right to "enforce relatively short statutes of limitation applicable to such actions." *McKesson*, 496 U.S. at 45.[20]

Because the Minnesota Supreme Court clearly misconstrued federal due process requirements as prohibiting such procedural bars to refund claims, this Court should grant certiorari.

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[20] *See also Ward v. Love County Bd. of Comm'rs*, 253 U.S. 17, 25 (1920) (acknowledging refund claim could be barred by "any valid local [limitations] law in force when the claim was filed").

CONCLUSION

For the reasons stated above, this Court should grant certiorari to clarify what process states must offer as a "meaningful opportunity" to challenge taxes before payment in order to extinguish their obligation to provide postdeprivation relief. In the alternative, petitioners request the Court to defer its decision on certiorari until it can be determined whether the outcome in *Reich v. Collins* will have a bearing on this case.

Respectfully submitted,

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STATE OF MINNESOTA

IN SUPREME COURT

C0-89-2097

Remand from United States Supreme Court

Gardebring, J.
Concurring Specially, Page, J.

Cambridge State Bank, et al.,

Respondents,

vs.

Filed: April 1, 1994
Office of Appellate Courts

John P. James, Commissioner, Department of Revenue, State of Minnesota,

Appellant,

and

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Respondent,

vs.

John P. James, in his capacity as Commissioner of Revenue, and The State of Minnesota,

Appellant.

SYLLABUS

Banks challenging unconstitutional bank excise tax imposed by Minn. Stat. § 290.361 (1984) (since repealed) in tax refund action pursuant to Minn. Stat. § 290.50 (1984) are entitled to refund of taxes paid on income from federal obligations.

Affirmed and remanded.

Considered and decided by the court en banc without oral argument.

OPINION

GARDEBRING, Justice.

This challenge to the bank excise tax imposed by Minn. Stat. § 290.361 (1984) (repealed 1987)[1] is before us on remand from the United States Supreme Court for reconsideration in light of the Court's decision in *Harper v. Virginia Department of Taxation*, ___ U.S. ___, 113 S.Ct. 2510 (1993). *Norwest Bank Duluth v. McClung*, ___ U.S. ___, 113 S.Ct. 3026 (1993) (remand order). We have considered this matter in two previous decisions. The lawsuit began

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[1] As we stated in our first decision in this case:

> Banks doing business in the State of Minnesota during the relevant period were required to pay a tax measured by their net income. Minn. Stat. § 290.361, subd. 1. That tax was governed by the provisions of Minn. Stat. § 290.02. *Id.* Both Minn. Stat. §§ 290.02 and 290.361 referred to an "excise" tax measured by taxable net income. Minn. Stat. § 290.08, subd. 8 (1984) (repealed 1987) exempted any interest earned on either United States or State of Minnesota obligations from gross income. That exclusion, however, *was not* applicable to "corporations taxable under section 290.02 *or 290.361.*" *Id.* (emphasis added). Consequently, for banks doing business in the state of Minnesota, interest earned on federal obligations was *included* in the taxable net income figure used to compute their chapter 290 excise tax.

Cambridge State Bank v. Roemer, 457 N.W.2d 716, 719 (Minn. 1990).

in August of 1984 when over 140 banks filed a consolidated refund action in district court for the tax years 1979-83, pursuant to the tax refund statute, Minn. Stat. § 290.50, subd. 2 (1984) (recodified at Minn. Stat. § 289A.50, subd. 7 (1992)).[2] The banks alleged that the bank excise tax violated the Borrowing and Supremacy Clauses of the U.S. Constitution, as well as 31 U.S.C. § 3124 (1982), because it exempted from taxation the banks' income from certain state obligations while it taxed income from federal obligations.[3] The banks based

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[2] Due to the applicable statute of limitations, the banks' refund claims were limited to the period from 1979 to the date of filing. The Minnesota legislature, however, had enacted provisions as early as 1957 overriding the bank excise tax and exempting interest earned on certain state bonds. *See* Act of April 24, 1957, ch. 603, § 2, 1957 Minn. Laws 753 (codified at Minn. Stat. § 136.32 (1978)) (revenue bonds issued by Minnesota State University System); Act of May 4, 1967, ch. 297, § 13, 1967 Minn. Laws 465 (codified at Minn. Stat. § 474.12 (1978)) (industrial development bonds).

[3] The federal statute that applies to this case, 31 U.S.C. § 3124 (1982) (formerly codified at 31 U.S.C. § 742), provides:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except –
>
> (1) a nondiscriminatory franchise tax, imposed on a corporation * * * .

The U.S. Supreme Court has stated that this statutory prohibition codified longstanding principles of constitutional law which preclude the states from taxing federal securities and income generated by them. *See Society for Savings v. Bowers*, 349 U.S. 143, 144 (1955).

their claim on the U.S. Supreme Court's decision in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983) which held that a similar Tennessee tax was unconstitutional.[4]

The trial was bifurcated into a liability phase and a remedy phase. Pursuant to a stipulation by the parties, the court heard evidence regarding four banks for the 1979 tax year. The parties agreed that the trial court's conclusion on liability would be conclusive as to all tax years at issue and all of the plaintiff banks. The trial court found the tax unconstitutional under *Memphis Bank*. The trial court found the state liable for refunds of the taxes the banks paid on interest on federal obligations, with the amount to be determined during the remedy phase of the trial. At the close of the remedy phase, the court assessed the state's liability for refunds at a total of $285,750.00 for the four test banks during the test year.

On review, we agreed with the trial court that the tax was discriminatory under *Memphis Bank*, but further held that the banks were estopped from challenging the statute's constitutionality because they benefitted from the exemptions for state bond income which made the tax unconstitutional. *Cambridge State Bank v. Roemer*, 457 N.W.2d 716, 720 (Minn. 1990) ("*Cambridge I*"). As to remedy, we concluded that *Memphis Bank* should be applied prospectively only, and that severance of the exemptions for interest income from state obligations was an appropriate remedy. *Id.* at 721-22.

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[4] The Minnesota legislature repealed the exemptions for income on certain state obligations in 1983 in response to the *Memphis Bank* case. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 613-25.

The U.S. Supreme Court granted certiorari in *Cambridge I*, vacated the judgment, and remanded the case for reconsideration in light of its decision in *James B. Beam Distilling Co. v. Georgia*, ___ U.S. ___, 111 S.Ct. 2439 (1991). *Norwest Bank Duluth v. James*, ___ U.S. ___, 111 S.Ct. 2881 (1991). *Beam* held that when the Supreme Court "has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata." *Beam*, ___ U.S. at ___, 111 S.Ct. at 2448. Upon reconsideration, we held that we were compelled by *Beam* to apply *Memphis Bank* retroactively, but we again denied the banks refunds on several grounds. *Cambridge State Bank v. James*, 480 N.W.2d 647 (Minn. 1992) ("*Cambridge II*"). First, we reaffirmed our estoppel holding, concluding that *Beam* allowed states to raise state procedural bars to the otherwise required retroactive application of *Memphis Bank* and that the "acceptance-of-benefits" estoppel doctrine was one such procedural bar. *Id.* at 652. We also affirmed our holding that severance of the exemptions for income on state obligations was an appropriate remedy, citing *Beam's* holding that the remedial decision is governed by state law when the case originates in state court. *Id.* at 653-54. We concluded again that the remedy of severance was "sufficient to cure the discriminatory tax." *Id.* at 655.

The U.S. Supreme Court again granted certiorari, vacated our *Cambridge II* judgment, and again remanded the case to us for reconsideration, this time in light of its decision in *Harper v. Virginia Department of Taxation*, ___ U.S. ___, 113 S.Ct. 2510 (1993). The Supreme Court's summary reconsideration order leaves the *Cambridge II* decision without force or effect. *State v. Hershberger*, 462

N.W.2d 393, 395 (Minn. 1990). The Supreme Court's order indicates that the Court has found the intervening precedent "sufficiently analogous and, perhaps, decisive to compel re-examination of the case." *Henry v. City of Rock Hill*, 376 U.S. 776, 777 (1964).

In *Harper*, the Virginia Supreme Court invalidated a state statute which taxed federal retirees' benefits while exempting from taxation benefits of state and local retirees. *Harper v. Virginia Dept. of Taxation*, 401 S.E.2d 868, 870 (1991), *rev'd* ___ U.S. ___, 113 S.Ct. 2510 (1993). The Virginia court, however, gave only prospective effect to its decision that the tax was unconstitutional. *Id.* at 873. After the U.S. Supreme Court vacated the decision and remanded it for reconsideration in light of *Beam*, the Virginia court reaffirmed its decision in all respects. *See Harper v. Virginia Dept. of Taxation*, 410 S.E.2d 629 (1991). The U.S. Supreme Court again granted certiorari, reversed and remanded, addressing both retroactivity and remedial issues. *Harper*, ___ U.S. ___, 113 S.Ct. 2510 (1993). Thus, our analysis turns on the application of *Harper* to the instant matter.

The Supreme Court's analysis of remedial issues in *Harper* affects our ruling in *Cambridge II*.[5] After finding the tax at issue in *Harper* unconstitutional, the Virginia

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[5] Harper's major effect on subsequent cases is the Court's holding that its application of a rule of federal law shall be given retroactive effect in all future cases. *Harper*, ___ U.S. ___, 113 S.Ct. at 2513. *See United Food and Commercial Workers Int'l Union, AFL-CIO, Local No. 150-A v. NLRB*, 1 F.3d 24, 35 (D.C. Cir. 1993). This holding has little effect on our decision in *Cambridge II*, however, as we applied the *Memphis Bank* decision retroactively in that decision.

Supreme Court had declined to order refunds for the federal retirees. *See Harper,* 401 S.E.2d at 874; 410 S.E.2d at 632. As we noted in *Cambridge II,* the U.S. Supreme Court has held that the remedial inquiry is one governed by state law where the case originates in state court. *Cambridge II,* 480 N.W.2d at 653 (citing *Beam,* 111 S.Ct. 2443). In *Harper,* however, the Court reversed the Virginia court and remanded the decision with the directive that the state court measure the relief provided by the state's remedial scheme against federal due process principles. *Harper,* ___ U.S. at ___, 113 S.Ct. at 2520. The Court cited the due process principles set out in *McKesson Corp. v. Division of Alcoholic Beverages,* 496 U.S. 18 (1990) as controlling precedent. A closer look at *McKesson* is therefore instructive.

In *McKesson,* the Court considered the scope of a state's obligation to provide taxpayers retrospective relief for payment of an unconstitutional tax. The Florida Supreme Court had found that its state liquor excise tax scheme violated the commerce clause and enjoined future enforcement of a preferential tax rate for state products, but declined to order a refund or any other form of relief for taxes already paid under the unconstitutional statute. *Division of Alcoholic Beverages and Tobacco v. McKesson,* 524 So.2d 1000 (Fla. 1988), *rev'd,* 496 U.S. 18 (1991). The U.S. Supreme Court reversed, holding that the unlawful exaction of taxes is a deprivation of property under the due process clause for which a state must provide procedural protections. *McKesson,* 496 U.S. at 36. The Court held that states may choose to provide either a predeprivation or a postdeprivation procedure. A predeprivation procedure must allow taxpayers to sue to enjoin imposition of the

tax prior to payment or to withhold payment and present their objections as defenses in a tax enforcement proceeding. *Id.* at 36-37. If the state opts for a postdeprivation procedure, however, it must provide one of the following "clear and certain" remedies: a refund of taxes unlawfully exacted, a retroactive tax on the benefitted taxpayers, or a combination of a partial refund and a partial retroactive assessment to create "in hindsight a nondiscriminatory scheme." *Id.* at 39-41.

In evaluating Florida's procedures, the Court concluded that because Florida had established various "sanctions and summary remedies" to encourage payment of taxes prior to resolution of disputes over the tax's validity, the state did not provide a *"meaningful"* opportunity for predeprivation relief and must therefore provide a "clear and certain remedy" for any unlawful exaction of taxes through its postdeprivation process. *Id.* at 38-39. The Court rejected the argument that equitable considerations, such as the state's good faith reliance on a presumptively valid statute, could override the constitutional requirement of retrospective relief. *Id.* at 44-49. The Court further held that the state's interest in financial stability could not justify a refusal to provide relief, but that its administrative costs and interest in avoiding serious economic dislocation could play a role in choosing and fine-tuning the relief to be provided. *Id.* at 49-51.

We reconciled our previous decisions with *McKesson* or found its analysis inapplicable to the *Cambridge* case for several reasons. First, we distinguished *McKesson* because it was a commerce clause case, rather than an intergovernmental tax immunity case like *Cambridge*. *Cambridge I*, 457 N.W.2d at 721; *Cambridge II*, 480 N.W.2d

at 653-54. We reasoned that the tax at issue in *McKesson* harmed one of two groups of competitors, and that this harm was absent here; in *Cambridge* all of the banks paid the same tax and thus none suffered any *Competitive* economic disadvantage. *Cambridge I*, 457 N.W.2d at 721; *Cambridge II*, 480 N.W.2d at 653. *Harper* clarifies that the U.S. Supreme Court considers *McKesson* controlling precedent in intergovernmental tax immunity cases as well, making the state's obligation to provide retrospective relief applicable to *Cambridge*. *See Harper*, ___ U.S. ___, 113 S.Ct. at 2519-20. After *Harper* we can no longer distinguish *McKesson* on the ground that it applies only to commerce clause cases.

Further, *Harper* holds that the existence of a predeprivation remedy which meets the tests set out in *McKesson* is a preliminary question which determines the remedy required for an unlawful tax under the Due Process Clause of the federal constitution. *Harper*, ___ U.S. at ___, 113 S.Ct. at 2519. Both the Minnesota Department of Revenue and the respondent banks agree that after *Harper* the existence of a meaningful predeprivation remedy is a necessary precondition to denying a retroactive remedy on any state law theory. If there was a meaningful predeprivation procedure in Minnesota at the time the tax was paid, then we have the option of denying backward-looking relief and state law bars to relief may come into play. If those procedures did not exist or were not "meaningful" then we must design a "clear and certain" backward-looking remedy which creates in hindsight a nondiscriminatory tax scheme.[6]

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[6] The constitutional standard set out in *McKesson* is rooted in the Due Process Clause requirement that an individual be

We concluded in *Cambridge II* that even if *McKesson* did apply to this case, there was a form of predeprivation procedure in place in Minnesota during the tax year at issue which satisfied the federal due process standards set out in *McKesson*. *Cambridge II* 480 N.W.2d at 651-52. We predicated our conclusions that the purely prospective relief of severance was adequate and that the banks were estopped from claiming refunds under a state law doctrine in part on the fact that a predeprivation procedure existed in Minnesota at the time these taxes were assessed. *Id.* at 652-54. We found that Minnesota provided taxpayers with the opportunity to challenge the tax statute in the tax court without first paying the taxes at issue.[7] Respondent banks, however, argue that the tax court procedure available in Minnesota in 1980 when the banks filed 1979 tax returns was not the *meaningful* opportunity for predeprivation relief required by

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given a hearing *before* being finally deprived of his property. *McKesson*, 496 U.S. at 36-37. The Supreme Court noted that many policy considerations support its opinions allowing states to deny a hearing until after a tax is paid. *Id.* at 37-38. The Court in *McKesson* simply held that if a state chooses that course, it must provide retrospective relief upon a subsequent determination that the tax was unlawfully exacted. *Id.* at 38-39.

[7] There is some ambiguity in our *Cambridge II* opinion regarding whether our holding was for the 1979 tax year only or for all of the tax years for which refunds are claimed. *Cambridge II*, 480 N.W.2d at 651. We examined the "1979-80 tax years" and concluded that "in each year at issue" Minnesota provided a predeprivation remedy. *Id.* The parties have always confined their arguments to the 1979 tax year; we are bound by the parties stipulation and thus analyze only the year which the parties stipulated would control the outcome for each year at issue.

McKesson. Given *Harper's* clarification that *McKesson* directly controls this case, we must carefully reconsider whether a predeprivation remedy which satisfies *McKesson's* requirements existed in Minnesota at the time the banks paid the tax.

In 1980, litigants challenging taxes in Minnesota were able to file for tax refunds in district court, but were required to pay the tax first. *See* Minn. Stat. § 290.50, subds. 1-2 (1980). Since 1977 the state has also had an administrative tax court with jurisdiction over all questions arising under the state's tax laws. Minn. Stat. ch. 271 (1992). Soon after the tax court's creation, however, we questioned its jurisdiction to decide constitutional issues.[8] We upheld the constitutionality of the administrative tax court itself in 1979, but cited as the saving feature of the statutory scheme creating the tax court, the fact that taxpayers had the option to elect a judicial remedy by filing in district court. *Wulff v. Tax Court of Appeals*, 288 N.W.2d 221, 224-25 (Minn. 1979).

In September of 1980, we held that the tax court did not have original jurisdiction over constitutional issues, but that the tax court could consider constitutional claims first transferred from district court.[9] *Matter of McCannel*,

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[8] In *Harris v. Commissioner of Revenue*, 257 N.W.2d 568 (Minn. 1977) we upheld a tax court ruling on the constitutionality of a statute, but we noted that the tax court's jurisdiction to hear a constitutional challenge to state statutes had not been challenged by either party. *Id.* at 569 n.1. We clarified that our decision intended no comment on that issue. *Id.*

[9] Based upon the record before us, the test banks apparently filed their taxes before *McCannel* was released. As the

301 N.W.2d 910, 919 (Minn. 1980); *see also Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138, 139 n.1 (Minn. 1980). Finally, in 1984 we affirmed the constitutionality of a procedure whereby the tax court could obtain jurisdiction over constitutional issues by transferring the case to the district court and having the district court transfer the case back to the tax court. *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261, 264 (Minn. 1984).

With this history in mind, the existence of some avenue for challenging the tax before paying 1979 taxes in early to mid-1980 can be asserted, but only with hindsight. Given that our 1977 decision in *Harris* had called into question the tax court's jurisdiction over constitutional issues, and that the issue remained unsettled, we do not think this mechanism provided the "meaningful opportunity" called for by *McKesson*. In contrast, a scheme for postdeprivation review clearly existed in early 1980 when the banks would have filed a lawsuit challenging the constitutionality of the tax. A state statute provided for refund actions in district court to recover taxes unlawfully collected. Minn. Stat. § 290.50 (1980). In light of the uncertainty regarding the reach of the tax court's jurisdiction and the clear availability of the statutory refund procedure, we cannot assert that the meaningful predeprivation remedy required by *McKesson* existed in early to mid-1980.

If the banks decided whether to pay the tax or challenge it after September of 1980, when *McCannel* held that

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parties have raised arguments dealing with the remainder of 1980, however, we have evaluated the remedies available during the entire year.

the tax court did not have jurisdiction over constitutional issues, the existence of a meaningful predeprivation remedy is even more questionable. The state argues that the banks would still have been able to have their case heard in tax court without prepayment, stating that after *McCannel* the tax court continued to consider cases raising constitutional issues which were filed in tax court before the *McCannel* decision was released. The state cites two such cases from 1981 and 1982. The state also cites a 1981 case, however, *Fussard v. Commissioner of Revenue*, No. 3183, 1981 WL 47632, at *6 (Minn. Tax Ct. 1981), in which the tax court ruled that cases directly questioning the validity of a state statute per se would be dismissed or referred to district court. That is precisely the type of case at issue; thus the banks' challenge would likely have been either dismissed or referred to district court. Dismissal of the lawsuit is hardly a meaningful predeprivation remedy.

The state also argues that the procedure for transfer of cases raising constitutional issues from tax court to district court and back to the tax court was practiced immediately after the *McCannel* decision. There are two problems with the state's argument. First, we did not affirm the constitutionality of that procedure until 1984 in the *Erie* case.[10] *See Soo Line Railroad Co. v. Commissioner of*

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[10] The state can only cite one action in which that procedure was followed prior to *Erie*, *Nagaraja v. Commissioner of Revenue*, 352 N.W.2d 373 (Minn. 1984). The *Nagaraja* case itself was filed as a refund action after taxes were paid. The banks' counsel submitted a copy of the state's brief in *Nagaraja* showing that the state itself argued that the Tax Court lacked jurisdiction to hear a constitutional challenge.

Revenue, 377 N.W.2d 453, 456 n.1 (Minn. 1985). Second, the state has not shown that such a procedure could be followed without paying the tax upon transfer to district court.

In conclusion, during the latter part of 1980 the applicability of a tax court proceeding to the type of case at issue, a per se challenge to a state tax statute, was doubtful after our decision in *McCannel*. Other uncertainties after *McCannel* also call into question the adequacy of a tax court proceeding as a predeprivation remedy. It is unclear, for example, whether the tax court would have dismissed the suit or used the transfer procedure that we later spelled out in *Erie* and, if it used the transfer procedure, whether the banks would have been required to pay the tax incident to the transfer to district court where prepayment is a prerequisite to litigation. Thus our conclusion that no meaningful predeprivation remedy existed holds for all of 1980.

The existence of the tax refund statute in Minnesota provides further support for our decision. To rely on the banks' use of the refund statute to now deny them a remedy would effectively deny the banks a meaningful hearing without adequate notice. Prior to the *McKesson* decision, taxpayers had no notice that they were required to take advantage of any predeprivation procedures in order to qualify for a refund. Even if there was a predeprivation remedy in 1980, the banks did not know when they chose between filing for a refund in district court and filing in tax court, that in choosing a refund action,

they were foreclosing their right to recovery.[11] Moreover, the tax refund statute did not have a requirement that the tax be paid under protest or that the taxpayer attempt to first take his or her claim to tax court. *See Brinkerhoff-Faris Trust and Sav. Co. v. Hill*, 281 U.S. 673 (1930) (finding due process violation when Missouri Supreme Court denied remedy to taxpayer by holding that taxpayer failed to take advantage of administrative remedies when court had previously found agency lacked power to hear the type of case at issue).

Having concluded that Minnesota did not provide a meaningful predeprivation remedy in 1980, *McKesson* commands that we design a clear and certain remedy which creates in hindsight a nondiscriminatory scheme. *McKesson*, 496 U.S. at 39-40. We have three choices: a refund of taxes paid on federal obligation income, a retroactive tax on exempted state obligation income or a combination of the two approaches. *Id.* at 40-41. Nothing in *Beam*, *Harper* or *McKesson* precludes us from considering equitable factors in designing the appropriate remedy. Such considerations may not result in a denial of the meaningful backward-looking remedy, but we may consider administrative costs in the selection and fine-tuning of the relief. *McKesson* 496 U.S. at 50-51.

We have considered each of the three possible remedies and choose to affirm the trial court's conclusion that all plaintiff banks are entitled to refunds of the

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[11] This issue did not arise in *McKesson* itself because the Court there found that taxpayers did not have a meaningful predeprivation remedy, thus a remedy was due regardless of whether it was required under Florida's tax refund statute.

unconstitutional tax on interest earned on federal obligations for all tax years in question. We noted in *Cambridge I* that the Minnesota Department of Revenue stipulated that it will not collect a retroactive tax on income from exempted state obligations. *Cambridge I*, 457 N.W.2d at 721. While we stand by our conclusion that the Revenue Department's stipulation could not limit our power to fashion an appropriate remedy, the stipulation is only one of the possible difficulties inherent in collecting a retroactive tax. Furthermore, the United States Supreme Court has not spoken clearly with regard to the constitutionality of a retroactive tax.[12] These problems are also inherent in a combination remedy; such a remedy would necessarily include a retroactive tax. While we recognize that this refund will place a serious burden on the state, we also note that the state has collected the unconstitutional tax for many years for which the banks will not recover due to the statute of limitations on tax refund actions.

We affirm the trial court's order from the remedial phase of the trial, including the court's conclusions as to all expense deductions at issue and the entitlement to

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[12] In *McKesson*, the Court noted that it had previously held that the retroactive assessment of a tax increase does not necessarily deny due process to those whose taxes are increased, though beyond some temporal point the retroactive imposition of a significant tax burden may be "so harsh and oppressive as to transgress the constitutional limitation," depending on "the nature of the tax and circumstances in which it is laid."

496 U.S. at 40 n.23 (citations omitted). We cited this language in *Cambridge II* and concluded that it would be unfair to impose and collect a curative tax on the banks in this case. *Cambridge II*, 480 N.W.2d at 654.

interest. The trial court determined the amount of the refund owed to each of the test banks for the 1979 tax year. On remand, the trial court should calculate the refund owed to the test banks for the remaining tax years and to the remaining plaintiff banks for all tax years at issue. Having given consideration to equitable factors in fine-tuning this refund remedy, we believe that the administrative and financial burden on the state justify allowing the state to pay the refund over the same period of time in which the tax was collected. Given that the tax was collected over a period of four years, we order that the trial court allow the state to administer its refund over a four-year period as well.

Affirmed and remanded to the trial court for the calculation of a refund schedule consistent with this opinion.

PAGE, Justice (concurring specially).

I would have reached the result the court reaches today through its elaborate analysis of *Cambridge I* and *Cambridge II* and relevant Supreme Court decisions more simply and directly. The refund statute in existence at the time the taxes were paid, Minn. Stat. § 290.50, subd. 5(b) (1978), provides. "Notwithstanding any other provision of law to the contrary, in the case of any overpayment the commissioner * * * shall refund any balance of more than one dollar * * * if the taxpayer shall so request." The language of this statute is clear and free from ambiguity and should be followed. Having determined that the taxpayers here paid taxes in excess of the amount legally due for the tax years in question, we should simply require compliance with the statute.

Supreme Court of the United States

No. 91-2047

NORWEST BANK DULUTH, N.A., ET AL.

Petitioners

v.

DOROTHY A. McCLUNG,
MINNESOTA COMMISSIONER OF REVENUE, ET AL.

ON WRIT OF CERTIORARI to the Supreme Court of Minnesota.

THIS CAUSE having been submitted on the petition for a writ of certiorari and response thereto,

ON CONSIDERATION WHEREOF, it is ordered and adjudged by this Court that the judgment of the above court in this cause is vacated and the case is remanded to the Supreme Court of Minnesota for further consideration in light of *Harper v. Virginia Department of Taxation,* 509 U. S. ___ (1993).

IT IS FURTHER ORDERED that the petitioners Norwest Bank Duluth, N.A., et al. recover from Dorothy A. McClung, Minnesota Commissioner of Revenue, et al. Three Hundred Dollars ($300.00) for their costs herein expended.

June 28, 1993

Clerk's costs: $300.00

STATE OF MINNESOTA
IN SUPREME COURT

No. C0-89-2097

United States Supreme Court Yetka, J.

Cambridge State Bank, et al.,

Respondents,

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Filed February 14, 1992
Respondent, Office of Appellate Courts

vs.

John P. James, Commissioner, Department of Revenue, and the State of Minnesota,

Appellants.

SYLLABUS

1. The United States Supreme Court decision in *James B. Beam Distilling Co. v. Georgia,* 111 S. Ct. 2439 (1991), requires retroactive application of the substantive rule of federal law established in *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983).

2. The *Beam* decision preserves the state's right to raise procedural bars to an otherwise required retroactive application of a federal substantive rule.

3. The *Beam* decision preserves the state's right to fashion an appropriate remedy for the violation of a substantive rule of federal law, at least where the case originates in state court.

The judgment of the trial court is affirmed in part and reversed in part.

Heard, considered and decided by the court en banc.

OPINION

YETKA, Justice.

The court first decided this tax refund case on July 20, 1990. *Cambridge State Bank v. Roemer,* 457 N.W.2d 716 (Minn. 1990). The United States Supreme Court granted certiorari, vacated, and remanded the cause to this court following its decision in *James B. Beam Distilling Co. v. Georgia,* 111 S. Ct. 2439 (1991).

When the case was first before this court, respondent banks challenged Minnesota's pre-1983 bank excise tax, Minn. Stat. § 290.361 (1984) (repealed 1987), which included interest from federal obligations in computing net income (on which the bank tax was measured), while exempting interest from certain state obligations. The banks claimed that the tax was a discriminatory income tax in violation of 31 U.S.C. § 3124(a) (1982). That section reads in pertinent part:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, *except* –
>
> > (1) *a nondiscriminatory franchise tax* or another nonproperty tax instead of a franchise tax, imposed on a corporation * * * .

Id. (emphasis added).

We held that the tax was a franchise rather than income tax, but agreed with the banks and the trial court that the tax was discriminatory because of its disparate treatment of state and federal obligation interest income. *Cambridge State Bank*, 457 N.W.2d at 719. Even though we found the tax discriminatory, we denied the banks a refund of the taxes paid on the federal interest income. We articulated three reasons for this denial.

First, we held that the banks should have been estopped from attacking the constitutionality of the bank tax's inclusion of federal obligation interest income because they had accepted the benefits of the state obligation interest exemptions. *Cambridge State Bank*, 457 N.W.2d at 720. Justice Kelley did not join in this part of the court's opinion. *Id.* at 723.

Second, we held that the proper remedy in this case was to sever the unconstitutional provisions of the tax because it was clear that the legislature would have enacted the tax statute without the unconstitutional provisions. *Id.* at 720-21.

Finally, we held that the United States Supreme Court's decision in *Memphis State Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), which held a nearly identical tax unconstitutional and was the authority under which this court found Minnesota's bank tax discriminatory, applied prospectively only under the three-part test in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). The *Chevron* case established the factors governing the non-retroactive application of judicial decisions. *Cambridge State Bank*, 457 N.W.2d at 722.

On August 2, 1991, this court ordered that the parties brief the specific issue of what effect, if any, the *Beam* decision has on the holdings in this case.

The United States Supreme Court's vacation of *Cambridge State Bank v. Roemer* leaves that decision without force or effect. *State v. Hershberger*, 462 N.W.2d 393, 395 (Minn. 1990) (*citing* Threlkeld v. Robbinsdale Fed'n of Teachers, Local 872, AFL-CIO, 316 N.W.2d 551, 552 (Minn.), *appeal dismissed*, 459 U.S. 802 (1982)). This court is not bound by and need not defer to the trial court's determination of legal questions in this case. *A. J. Chromy Constr. Co. v. Commercial Mechanical Serv., Inc.*, 260 N.W.2d 579, 582 (Minn. 1977).

The issues presented by this remand order are:

I. Does *Beam* require retroactive application of the substantive rule of federal law established in *Memphis Bank & Trust Co. v. Garner*?

II. Does *Beam* preserve the state's right to raise procedural bars to an otherwise required retroactive application of a federal substantive rule?

III. Does *Beam* preserve the state's right to fashion an appropriate remedy for the violation of a substantive rule of federal law, at least where the case originates in state court?

I.

This court held that the rule enunciated in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983) invalidated

Minnesota's bank tax as discriminatory under 31 U.S.C. § 3124(a) (1982), but denied refunds to the banks on the ground that the Memphis Bank rule applied prospectively under *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). *Cambridge State Bank*, 457 N.W.2d at 722-23. Although there is no majority rationale in *Beam*, six justices agreed that the prospective application of a rule announced in any given civil case is either prohibited or severely limited by constitutional restraints.[1] We hold that our original prospective application holding does not survive in *Beam's* wake.

In *Beam*, the James B. Beam Distilling Company had sought a tax refund of $2.4 million from the state of Georgia for the imposition of a liquor tax that distinguished between imported and local alcoholic products. 111 S. Ct. at 2442. In *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), the U.S. Supreme Court had invalidated, under the commerce clause, an identical Hawaiian tax. The question squarely presented to the Court in *Beam* was whether the *Bacchus* ruling should apply retroactively to claims arising on facts antedating that decision. The state court, using a *Chevron Oil* analysis, had held that *Bacchus* did not apply retroactively. 111 S. Ct. at 2442.

Justice Souter's *Beam* opinion held that the retroactive application of a rule announced in a civil case, is, in the first instance, a choice-of-law (rather than remedial) question " 'between the principle of forward operation

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[1] Justice Souter announced the judgment of the Court and delivered an opinion in which Justice Stevens joined. Justices White, Blackmun, Marshall and Scalia concurred in the judgment.

and that of relation backward.' " 111 S. Ct. at 2443 (*quoting* Great Northern Ry. Co. v. Sunburst Oil & Refining Co., 287 U.S. 358, 364 (1932)). Where the decisional rule derives from federal law, constitutional or otherwise, the choice-of-law question of retroactivity is a federal one. *Id.* The general rule is one of retroactivity; if an opinion does not "reserve the question whether its holding should be applied to the parties before it * * * it is properly understood to have followed the normal rule of retroactive application in civil cases." *Id.* at 2445. Thus, under Justice Souter's analysis, it is error "to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so. * * * [P]rinciples of equality and *stare decisis* * * * prevail[] over any claim based on a *Chevron Oil* analysis." *Id.* at 2446.

Justice Souter's main concern with the *Chevron Oil* analysis is the consideration of equities, in the first instance, in determining whether a rule of law should not apply retroactively. *Id.* at 2448 ("The applicability of rules of law are not to be switched on and off according to individual hardship * * * ."). Equitable and reliance interests, in Justice Souter's view, may be considered "when deciding remedial issues in particular cases," but only after the choice-of-law question has been settled. *Id.*

Our conclusion that the rule in *Memphis Bank* should not apply retrospectively under *Chevron Oil* fails under Justice Souter's analysis. First, *Memphis Bank* did not reserve the question of whether its holding should be applied to the parties before it; therefore, its holding applied both to those parties and retroactively. The state argues here that the United States Supreme Court was not required and did not reach the retroactivity question

because the *Memphis Bank* parties stipulated to the result. However, the stipulation as to the result confuses the choice-of-law question with that of remedy. Remedial factors have no place in the consideration of whether a substantive rule of law applies in the first instance in a given situation. Moreover, *Memphis Bank's* silence on the issue requires application of the "normal" rule of retroactivity.

Justice White concurred in *Beam* to emphasize that the *Chevron Oil* analysis might still apply in some situations, such as where a new rule is announced as a result of an express overruling of existing precedent. 111 S. Ct. at 2448-49. The concurrences of Justices Blackmun and Scalia conclude that the prospective application of new decisional rules "breaches [the Supreme Court's] obligation to discharge our constitutional function." *Id.* at 2449-51. Each of these three concurrences invalidates this court's holding that *Memphis Bank* applies prospectively only under *Chevron Oil.*

In light of the *Beam* decision, we hereby reverse our original conclusion in *Cambridge State Bank* that the rule in *Memphis Bank* applies only prospectively.

II.

This court held that the respondent banks were estopped, under the acceptance-of-benefits doctrine in tax cases, from asserting the unconstitutionality of the Minnesota bank tax. Because the banks accepted the tax benefits of the exemption for state obligation interest, the banks improperly challenged the unconstitutionality of the bank tax. *Cambridge State Bank,* 457 N.W.2d at 720.

Although we have questioned the continued vitality of the acceptance-of-benefits doctrine in other areas of law, in *Cambridge State Bank* we reaffirmed the doctrine's use in tax cases. *Id.* We do so again on remand.

In stressing the distinction between the choice-of-law question of retroactivity and that of remedy, Justice Souter indicated that "[n]othing we say here deprives [respondent state] of [its] opportunity to raise procedural bars to recovery under state law" and that *Beam's* retroactivity holding applies "with respect to all others not barred by procedural requirements or res judicata." 111 S. Ct. at 2446. We think this court's estoppel holding is one such state procedural bar.

Respondent banks argue that the estoppel theory is simply another method of applying the holding in *Memphis Bank* prospectively. We do not believe this argument undercuts *Beam's* express holding that this court may rely on an established state procedural bar to challenge a tax statute unless that prohibition is itself unconstitutional. *Beam,* 111 S. Ct. at 2443 (remedial inquiry subject to constitutional thresholds); *see also McKesson Corp. v. Division of Alcoholic Beverages & Tobacco, Dep't of Business Regulation of Florida,* 110 S. Ct. 2238, 2250 (1990) ("Because exaction of a tax constitutes a deprivation of property, the State must provide procedural safeguards against unlawful exactions in order to satisfy the commands of the Due Process Clause.").

Indeed, respondent banks have asserted that the estoppel theory is unconstitutional. They argue that the estoppel theory "in essence" required them to pay a tax that was not imposed on anyone else as a precondition to

challenge the federal obligation interest taxation (*i.e.*, they would have had to pay a tax on the exempted state bond interest before they would be allowed to challenge the tax on the federal obligation interest).

This argument ignores a significant point, however. For the 1979-80 tax years,[2] Minnesota law did not require prepayment in order to challenge the validity of a tax. *See* Minn. Stat. § 271.09, subd. 3 (1978) (when appealing to the tax court, "the taxpayer shall pay at least the amount of the tax or other obligation conceded by the taxpayer to be due, *if any*, when it becomes due * * * ." (Emphasis added.)). Respondent banks argue that the tax court did not have the authority to decide the constitutionality of a tax after our decisions in *In re McCannel*, 301 N.W.2d 910, 920 (Minn. 1980), and *Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138, 139 n.1 (Minn. 1980). However, we believe that this argument confuses the issue of whether the banks could have challenged the tax at the time it was due without first paying it with the procedures for claiming a refund under the tax statute.

Before 1980, the tax court had subject matter jurisdiction over constitutional challenges to taxes assessed. *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261, 264 (Minn. 1984).[3] There was no prepayment requirement

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[2] The parties stipulated that 1979 would be the "test year" for purposes of this litigation. Respondent banks have filed claims including 1980-1983 as well.

[3] In *Erie Mining*, we held:

> All tax matters over which the tax court has jurisdiction should be filed with the tax court. If any party raises a constitutional issue, the tax court should stay

for bringing an appeal to tax court until 1987. *See* Minn. Laws ch. 268, art. 14, § 12 (codified at Minn. Stat. § 271.061 (1987 Supp.)) (repealed 1989). We think it is reasonable to assume that the banks would have avoided paying the tax at the time it was due by bringing their claims in tax court. More important, however, is the fact that, in each year at issue, the banks *could have* avoided paying the tax before challenging its constitutionality. Thus, there were sufficient procedural safeguards against unlawful exactions of the tax *at the time it was assessed.*

Even when there was a prepayment requirement, a taxpayer could avoid prepayment by showing:

> (1) That the proposed review is to be taken in good faith;
>
> (2) That there is probable cause to believe that the taxpayer may be held exempt from the tax or that the tax may be determined to be less than 50 percent of the amount due; and
>
> (3) That is would work a substantial hardship upon petitioner to pay the tax.

Minn. Stat. § 290.531 (1982) (repealed 1987).

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the proceedings and refer the constitutional question to the district court. The district court may either decide the constitutional issue or refer the matter back to the tax court which will then have subject matter jurisdiction to rule initially on the constitutional issue. If the tax court should declare any matter unconstitutional and no appeal is taken to this court, that ruling shall only be the law of the particular case involved.

343 N.W.2d at 264.

Thus, respondent banks are incorrect in arguing that there were no "predeprivation processes" available to challenge the tax on the federal obligation interest at the time it was paid. Moreover, the processes available in Minnesota appear to satisfy the federal Constitution's due process requirements. *See McKesson*, 110 S. Ct. at 2250 (in satisfying the commands of the due process clause, "[t]he State may choose to provide a form of 'predeprivation process,' * * * by authorizing taxpayers to bring suit to enjoin imposition of a tax prior to its payment * * * .").

Respondent banks also assert that the acceptance-of-benefits estoppel doctrine applies only where a claimant receives a benefit from the very statute challenged as unconstitutional. *See Kadrmas v. Dickinson Pub. Schools*, 487 U.S. 450, 457 (1988). While respondent banks note that they challenged the tax on the federal obligation interest, they fail to note that the tax was discriminatory *precisely because of* the state obligation interest exemptions. In other words, a tax based in part on federal obligation interest income is not *per se* discriminatory; only when that tax is read in conjunction with the state exemptions does its imposition become discriminatory.[4] Accordingly, although the tax and exemptions were imposed and granted in different chapters of Minnesota statutes, they must be read as part of one taxation scheme to be challenged in the first instance. Respondent banks' argument would elevate form over substance.

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[4] In *Kadrmas*, there was no such nexus between the statute granting the "benefit" and that being challenged. 487 U.S. at 457.

Finally, respondent banks assert that the "benefit" they received from the state obligation interest exemptions is "wholly illusory" because the state obligation exemptions caused the interest rates for those obligations to be lower than they would have been without the exemption. The trial court's findings of fact substantially support this claim.

On the other hand, the amount of profit generated (or not) by the lower interest rate is not the measure of whether the banks received a "benefit." On the contrary, the banks did not pay taxes on *any* of the interest earned on the subject state obligations. Regardless of the interest rate the banks charged, the exemption from taxation was the benefit they received. Indeed, according to the trial court's findings, the state obligation interest exemptions "alone increase[d] the interest rates on certain federal obligations." Thus, the banks not only operated free from tax on the state obligation interest, but also received higher rates from federal borrowers.

Accordingly, we reaffirm our original acceptance-of-benefits estoppel holding as a state procedural bar to respondents' claims because the *Beam* decision expressly allows a state procedural law to prohibit the otherwise required retroactive application of a judicial decision.

III.

This court's third holding in *Cambridge State Bank* denied the respondent banks a refund to the taxes paid on the federal obligation interest for the years at issue. The court based its denial on the sufficiency of severance as a remedy for the discrimination caused by the tax.

Under Minnesota's severance statute, Minn. Stat. § 645.20 (1988), we indicated that we could properly sever the discriminatory portion of the bank tax (*i.e.*, the provisions exempting the state obligation interest). *Cambridge State Bank*, 457 N.W.2d at 720. When the legislature first enacted the bank tax, there were no state obligation interest exemptions; accordingly, the later exemptions (which caused the defect in the tax) cannot be said to have "invalidated the *entire* original Act." *Id.* at 720 (emphasis in original).

In addition, we ruled that the severance of the state exemptions in this case satisfied the due process requirement of providing an adequate post-deprivation remedy. *Id.* at 721. If a tax is unlawful under the commerce clause, the actual imposition of a curative tax or a refund of the tax exacted is required to equalize the comparative economic disadvantage caused by the discriminatory tax. *See id.; see also McKesson*, 110 S. Ct. at 2247 ("[T]he Due Process Clause * * * obligates the State to provide meaningful backward-looking relief to rectify any unconstitutional deprivation."). Here, there was no comparative economic disadvantage among competitors – each of the banks held both federal and state obligations. Accordingly, neither actual imposition of a curative tax nor refund of taxes paid was required. *Cambridge State Bank*, 457 N.W.2d at 721.

Finally, we noted that we would have assessed and collected a tax to cure the constitutional infirmity of the tax in question in spite of the Revenue Department's stipulation that it would not actually collect such a curative tax. *Id.* However, we did not impose the curative tax

because we reasoned that, "[w]ere it not for our conclusion that the *Memphis Bank* case [applies prospectively] * * * we would order the Revenue Department to assess and collect the tax attributable to the state obligation interest income." *Id.* at 722.

In *Beam,* Justice Souter noted that, "[s]ubject to possible constitutional thresholds, the remedial inquiry is one governed by state law, at least where the case originates in state court." 111 S. Ct. at 2443 (citations omitted); *accord American Trucking Ass'ns v. Smith,* 110 S. Ct. 2323, 2348 (1990) (Stevens, J., dissenting) ("The remedial effect a decision of federal constitutional law should be given is in the first instance a matter of state law."). Moreover, requiring retroactive application of a decisional rule does not deprive a party from demonstrating reliance and equitable interests in determining the nature of the remedy that must be provided. *Beam,* 111 S. Ct. at 2447-48; *see also United States v. Estate of Donnelly,* 397 U.S. 286, 297 (1970 (Harlan, J., concurring) ("To the extent that equitable considerations, for example, 'reliance,' are relevant, I would take this into account in the determination of what relief is appropriate in any given case.").

Thus, the *Beam* decision fundamentally affects the analysis a state court must undertake in fashioning a remedy in a case of this type. First, the "constitutional thresholds" to which Justice Souter referred were those enunciated in *McKesson.* There, the U.S. Supreme Court unanimously held that prospective relief from a tax invalidated under the commerce clause, by itself, does not satisfy the requirements of the due process clause where "a State places a taxpayer under duress promptly to pay a tax when due and relegates him to a post-

payment refund action in which he can challenge the tax's legality." 110 S. Ct. at 2247.

We distinguished *McKesson* on the ground that tax schemes invalidated under the commerce clause involve considerations of comparative economic disadvantage which are not present here. Here, the tax is applied to all banks in an equal manner. Respondent banks also contend that the United States Supreme Court's decision in *Montana National Bank v. Yellowstone County*, 276 U.S. 499 (1928), stands for the proposition that a refund of the taxes paid is the only remedy for a discriminatory tax even where the tax is not invalidated under the commerce clause. However, that case involved the same comparative economic disadvantage – between federal- and state-chartered banks – as that involved in other commerce clause tax cases.

Moreover, *McKesson* is distinguishable on the ground that respondent banks' payment of the tax was not made under duress in the sense that payment was compelled in order to challenge the tax. As noted in part II above, Minnesota provided the banks with the required "meaningful opportunity to withhold payment and to obtain a predeprivation determination of the tax assessment's validity." *McKesson*, 110 S. Ct. at 2251 (footnote omitted). We think that purely prospective relief – the severance of the state obligation interest exemptions – is a sufficient remedy in this case.

The corporate banks in this case are in no better position than would be an individual taxpayer who challenged an entire income tax on the basis that only one part of the tax has been deemed infirm. For example, a

taxpayer might be required by Congress or a state legislature to include income from certain investments, both state and federal, for income tax purposes. If the United States Supreme Court later held that the portion of the tax on federal investments were invalid, the taxpayer would not get far in arguing that the income on the state investments is exempt from taxation as well, resulting in no tax liability.

We think the severance remedy is also appropriate because the legislature has mandated it as a cure for an unconstitutional exaction of a tax. In 1983, after *Memphis Bank* was decided, the legislature cured the discriminatory impact of the tax by abolishing the exemptions for state obligation interest in the computation of gross income. *See* 1983 Minn. Laws ch. 213. In according proper deference to what the legislature has deemed an appropriate remedy, we think we are justified in holding severance to be a suitable cure for the tax's discriminatory impact in this case.

Additionally, this court is entitled to consider "reliance" interests in fashioning a remedy in this case. *Beam*, 111 S. Ct. at 2447-48. Respondent banks may be correct in arguing that the state legislature would not have enacted the state obligation interest exemptions had it "relied" on state and federal case law. However, it would be incorrect to argue that the legislature would not have enacted a bank franchise tax based, at least in part, on federal obligation interest income. We believe the "reliance" interests to which Justices Souter, Stevens and Harlan all referred in this context are not so narrowly defined as to include only "reliance" on case law. Indeed, as this court pointed out in *Cambridge State Bank*, 20 years

of unchallenged reliance on the validity of the tax involved here counters the notion that either the banks or the state did not "rely" on the tax scheme. 457 N.W.2d at 722.

We decline to penalize the state for relying on the tax scheme in this case by ordering a refund. We still believe the most appropriate remedy is to impose a curative tax. However, we believe the imposition of such a curative tax would be unconstitutional at this late date.[5] Moreover, in light of the lower interest rates which the banks charge to its state borrowers, such a tax would penalize the banks unfairly.

Finally, the state's reliance interests are inextricably intertwined with the equities of the instant case. As we have noted, it would be inequitable, nearly impossible, and probably unconstitutional to impose a curative tax in this case. Nevertheless, simply because a curative tax cannot be imposed to remedy the discriminatory tax, it does not follow that the only alternative remedy is to refund the tax exacted. This reasoning would require us

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[5] Although a curative tax for the years 1979-83 would cure the discrimination, we think it would be unfair to impose and collect a tax on the banks in this case. Indeed, the U.S. Supreme Court has held that

> the retroactive assessment of a tax increase does not necessarily deny due process to those whose taxes are increased, though beyond some temporal point the retroactive imposition of a significant tax burden may be "so harsh and oppressive as to transgress the constitutional limitation," depending on "the nature of the tax and the circumstances in which it is laid."

McKesson, 110 S. Ct. at 2252 n.23 (*citing* Welch v. Henry, 305 U.S. 134, 147 (1938)).

to ignore the state's equitable interests (its potential liability) while "overlooking" the fact that the banks could have challenged the tax at the time it was paid.[6] In this light, the equities of the case require the denial of the refunds requested.

We, therefore, reaffirm our original denial of the tax refunds sought by respondent banks, holding that the severance remedy is sufficient to cure the discriminatory tax in this case.

The judgment of the trial court is affirmed in part and reversed in part.

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[6] It is interesting to note that in the first appeal to this court, the banks argued vigorously that *Memphis Bank* did not establish a new rule of law that would allow prospective application. Now, of course, the banks contend that their failure to challenge the tax at the time it was paid due to a non-existent "prepayment" requirement.

STATE OF MINNESOTA

IN SUPREME COURT

No. C0-89-2097

Ramsey County

Yetka, J.
Concurring specially, Kelley, J.

Cambridge State Bank, et al.,

Respondents,

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Filed July 20, 1990
Office of Appellate courts

Respondent,

vs.

Arthur C. Roemer, Commissioner, Department of Revenue, and the State of Minnesota,

Appellants.

SYLLABUS

1. A taxpayer who assumes the validity of a statute by invoking its provisions in order to obtain a tax benefit is estopped from attacking the statute's constitutionality.

2. Where it is clear that the legislature would have enacted a statute without the provisions which are unconstitutional, the proper procedure is to apply Minn. Stat. § 645.20 (1988) and sever the invalid provisions.

3. Pursuant to the three-part test set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1983), the United States Supreme Court's decision in *Memphis Bank & Trust*

Co. v. Garner, 459 U.S. 392 (1983), must be applied prospectively.

Affirmed in part, reversed in part.

Heard, considered and decided by the court en banc.

OPINION

YETKA, Justice.

In the autumn of 1984, respondent banks commenced a tax refund claim in the district court of Ramsey County pursuant to Minn. Stat. § 290.50, subd. 2 (1988). This consolidated action by over 170 Minnesota banks sought tax refunds for the tax years 1979 through 1983. The district court concluded that the pre-1983 Minnesota bank excise tax imposed by Minn. Stat. § 290.361 (1984) (repealed 1987) is, in substance, an income tax and discriminates against federal debt instruments in violation of the borrowing and supremacy clauses of the United States Constitution. The court found that the inclusion of interest from federal obligations in the calculation of the banks' franchise tax was discriminatory and, therefore, in violation of 31 U.S.C. § 2124(a) (1982) (formerly numbered § 742)[1] because interest from certain state obligations was exempt from the calculation of the tax.

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[1] 31 U.S.C. § 3124 (1982) provides:

(a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, *except* –

(1) *a nondiscriminatory franchise tax* or another nonproperty tax instead of a franchise tax, imposed on a corporation * * *.

(Emphasis added.)

The district court ordered the State of Minnesota to refund to respondents, with interest, taxes collected under the statute between 1979 and 1983. We affirm in part and reverse in part.

The record in this case includes a detailed stipulation of facts entered into by the parties. The trial was bifurcated into two phases: Phase I, a liability phase, and Phase II, a remedy phase. The issue of liability was tried before the court on November 6-17, 1986. By agreement of counsel and order of the court, evidence was presented by four banks for the 1979 tax year. The four banks were: Cambridge State Bank, Midway National Bank of St. Paul, First Security State Bank of Sleepy Eye, and Norwest Bank Duluth. The court heard lengthy and detailed testimony from several expert witnesses concerning the economic impact of the tax on the borrowing power of the federal government. The parties agreed that the conclusion of the court on the liability phase would be conclusive as to all tax years at issue and all of the plaintiff banks. Pursuant to statute, the measure of the tax paid by these banks included interest income earned on obligations of the United States government, but did not include interest income earned by the banks on obligations of certain agencies of the State of Minnesota. Respondents filed timely protective claims for refunds for the tax year 1979 and timely filed these actions for refunds.

The trial court concluded that the tax violated 31 U.S.C. § 3124. In summary, section 3124 provides that obligations of the United States government are immune from state and local taxation, but interest earned on these obligations may be included in the measure of a "non-

discriminatory" corporate franchise tax. The trial court concluded that the Minnesota tax was a discriminatory income tax and, therefore, violated the supremacy and borrowing clauses of the United States Constitution. The court's conclusion regarding discrimination was premised on a finding that, under Minnesota law, interest earned on obligations of the United States Government was included in the computation of the corporate franchise tax whereas interest earned on certain obligations[2] of the State of Minnesota was exempt from the computation of the corporate franchise tax.

The trial court also concluded that, although the tax imposed by Minn. Stat. § 290.361 (1984) is labeled an "excise" tax, it is a direct tax on net income for purposes of federal statutory and constitutional law. The trial court rejected all of appellants' arguments and ordered that the appellants were liable for refunds in amounts to be determined in Phase II of the trial. On August 28, 1989, following Phase II of the trial, the court ruled that appellants were liable for refunds, with interest, and ordered retroactive relief in the following amounts: Norwest –

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[2] Appellants dispute the number of obligations that are exempt from the computation of the corporate franchise tax. Appellants concede, however, that at least two state/municipal obligations were exempt:

(1) Industrial Development Bonds issued under Minn. Stat. ch. 474 prior to June 30, 1979; and
(2) State University Bonds issued under Minn. Stat §§ 136.31-.38;

Given that the parties have stipulated that at least some state obligations were exempt, this court need not reach the issue of whether the other types of obligations were actually exempt.

$189,065; Sleepy Eye – $36,278; Cambridge – $23,833; and Midway – $46,574. This appeal followed.

I. The first issue raised by this appeal is whether the bank tax imposed under section 290.361 and governed by Minn. Stat. § 290.02 (1988) is a non-discriminatory franchise tax. This court has determined that the tax imposed by section 290.02 is a franchise tax. *Reuben L. Anderson-Cherne, Inc. v. Commissioner of Taxation*, 303 Minn. 124, 226 N.W.2d 611, *appeal dismissed*, 423 U.S. 886-87 (1975) (dismissed for lack of substantial federal question). Respondents ask this court to overrule *Reuben* on the grounds that, in "economic effect," the tax is an income tax. According to this theory, the tax would clearly violate 31 U.S.C. § 3124 and would, therefore, be unconstitutional under the borrowing clause of the United States Constitution. The trial court accepted this theory and concluded that the tax is an income tax. We disagree.

The trial court's conclusion on this issue is inconsistent with the legislative history of section 3124 and *Reuben*. In *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 870-71, n.13 (1983), the United States Supreme Court observed that the inability of states to include interest from federal obligations in an *income* tax was the primary reason for enacting tax legislation permitting the imposition on national banks of *non-discriminatory franchise* taxes based on corporate income. Thus, the exception for non-discriminatory franchise taxes measured by income appears to be an intentional elevation of form over substance in recognition of the fact that banks would otherwise operate totally tax free.

In *Reuben*, this court noted that 31 U.S.C. § 3124 was amended in 1959 so as to permit the inclusion of interest from federal obligations in the computation of a non-discriminatory franchise tax and reasoned that to conclude the tax imposed by section 290.02 was, in reality, an income tax would render the 1959 amendment "completely meaningless." *See Reuben*, 303 Minn. at 130, 226 N.W.2d at 615. The *Reuben* court's determination that the tax levied on the income from interest on government obligations is a franchise tax is supported by this court's decision in *Soo Line R.R. Co. v. Commissioner of Revenue*, 377 N.W.2d 453 (Minn. 1985), where the court observed that "[t]he incident of the *franchise* taxed under the excise tax,[3] however, is the privilege of carrying on business, not the property of the franchise." *Id.* at 455 (emphasis and footnote added; citation omitted). The reasoning of the *Reuben* court is also supported by the United States Supreme Court's observations in *American Bank & Trust*. Accordingly, we reverse the trial court's conclusion that the bank tax is an income tax for purposes of section 3124 and conclude instead that it is a franchise tax. As a result, the next question is whether it is "non-discriminatory."

Our review of the relevant statutes convinces us that the tax in question is discriminatory. Banks doing business in the State of Minnesota during the relevant period were required to pay a tax measured by their net income.

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[3] An excise tax is a tax imposed on the performance of an act, the engaging in of an occupation, or the enjoyment of a privilege, including corporate privileges. In current usage, the term includes practically every internal revenue tax except the income tax. Black's Law Dictionary 506 (5th ed. 1979).

Minn. Stat. § 290.361, subd. 1. That tax was governed by the provisions of Minn. Stat. § 290.02. *Id.* Both Minn. Stat. §§ 290.02 and 290.361 referred to as an "excise" tax measured by taxable net income. Minn. Stat. § 290.08, subd. 8 (1984) (repealed 1987) exempted any interest earned on either United States or State of Minnesota obligations from gross income. That exclusion, however, *was not* applicable to "corporations taxable under section 290.02 or *290.361.*" *Id.* (emphasis added). Consequently, for banks doing business in the State of Minnesota, interest earned on federal obligations was *included* in the taxable net income figure used to compute their chapter 290 excise tax. Certain state bond enabling statutes, however, overrode the above provisions of chapter 290 and exempted interest earned thereon from inclusion in income for the purpose of calculating chapter 290 taxes. *See* Minn. Stat. § 136.32 (1982) (amended 1983) ("SUB's"); Minn. Stat. § 474.12 (1982) (repealed 1983) (Municipal Industrial Development Bonds ("IDB's")).[4]

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[4] The trial court also found that interest earned on obligations of the following State of Minnesota agencies was exempt from inclusion in the bank tax:

Minnesota Higher Education Coordinating Board Bonds
Minnesota Higher Education Facilities Authority Bonds
Metropolitan Transit Commission Bonds
Public Water and Sewer Bonds
Hospital District Bonds
Hospital Revenue Bonds
St. Cloud Transit Commission Bonds
Metropolitan Waste Control Commission Bonds
Housing Redevelopment Authority Bonds
Area Redevelopment Agency Bonds

The trial court, in reliance on *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 398 (1983), concluded that, during the 1979 through 1983 calendar years, the bank tax was discriminatory because interest from certain State of Minnesota obligations was exempt.[5] Appellants concede that, at least as to IDB's and SUB's, the bank tax is discriminatory. Although we question the judgment of appellants in making this concession, the trial court's conclusion that the bank tax was discriminatory is affirmed as the law of this case.

II. The second issue presented by this appeal is whether the bank tax falls within a *de minimis* exception to section 3124. Appellants argue that the impact of the bank tax on the borrowing power of the United States government is *de minimis* and, therefore, the constitutional defects should be ignored. Appellants' *de minimis* defense is apparently based on dicta in *Memphis Bank & Trust* where, in a footnote, the Court stated:

> We cannot regard the impact of the discrimination as *de minimis*. According to the United States, which filed a brief as *amicus curiae* in support of reversal, if all 50 States enacted provisions comparable to the Tennessee bank tax, the United States would incur additional annual borrowing costs estimated at $280 million at an interest rate of 12%.

Id. at 398 n.8 (citation omitted).

Minnesota State Armory Commission Bonds
Solid Waste Management District Bonds

[5] In 1983, the Minnesota Legislature repealed the exemption provisions contained in numerous state obligation enabling statutes. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 614-25.

In the present case, the trial court concluded that there is no *de minimis* defense and found that, even if there were such an exception, "[t]he economic incidence of this discrimination would be far from de minimis, reaching into the billions of dollars of increased federal expense." We cannot say that the trial court's finding was clearly erroneous; thus, we conclude that the impact of the bank tax on federal borrowing was not *de minimis*. Accordingly, even assuming, *arguendo*, that there is a *de minimis* exception to section 3124, it is not applicable in the instant case.

III. Appellants argue that respondents should be estopped from asserting their claims that exemption of IDB's and SUB's from the bank tax discriminated against federal obligations under the acceptance-of-benefits doctrine. In *Gale v. Commissioner of Taxation*, 228 Minn. 345, 37 N.W.2d 711 (1949), the taxpayer sought to invoke the provisions of a tax statute to secure the benefit of a tax computation and, at the same time, challenged the constitutionality of another provision of the same act. *Id.* at 352, 37 N.W.2d at 716. This court said: "[H]e who assumes the validity of a statute by invoking its provisions to obtain a tax reduction may not attack its constitutionality." *Id.* (citing *Byard v. Commissioner of Taxation*, 209 Minn. 215, 296 N.W. 10 (1941)).

Respondents do not dispute that they accepted the tax benefits of the exemption for interest on State of Minnesota obligations. Instead, respondents suggest that the acceptance-of-benefits doctrine of estoppel is no longer good law. In *Wegan v. Lexington*, 309 N.W.2d 273, 277 (Minn. 1981), this court did not reject the acceptance-of-benefits doctrine in tax cases like *Gale* and *Byard*. *See*

Wegan at 277. We conclude, therefore, that, under the rule in *Gale*, respondents should be estopped from challenging the constitutionality of the bank tax. We do not, however, decide this case on that ground alone.

IV. Based on Minn. Stat. § 645.20 (1988), appellants ask this court to declare the language in the various state obligation enabling statutes which exempt the interest earned thereon from taxation to be unconstitutional and sever it from the remaining portion of the statutes. This is a compelling argument. Minn. Stat. § 645.20 (1988) provides, in pertinent part, as follows:

> If any provision of law is found to be unconstitutional and void, the remaining provisions of the law shall remain valid, unless the court finds the valid provisions of the law are so essentially and inseparably connected with, and so dependent upon, the void provisions that the court cannot presume the legislature would have enacted the remaining valid provisions without the void one * * * .

It is the exemption for interest earned on state obligations that makes the bank tax discriminatory and, therefore, unconstitutional. Moreover, since the legislature amended the statutes in question by deleting the challenged exemptions, this court can presume that the legislature would have enacted the remaining provisions without the void one.

Indeed, when the legislature adopted the bank franchise tax in 1941, it did not exempt the disputed state interest revenue. *See* Act of Feb. 21, 1941, ch. 18, § 4, 1941 Minn. Laws 23, 24. The provisions exempting interest of certain state obligations were not enacted until 1957 and

1967. Act of Apr. 24, 1957, ch. 603, § 2, 1957 Minn. Laws 753 (SUB's); Act of May 4, 1967, ch. 297, § 12, 1967 Minn. Laws 456, 465 (IDB's). Can it be said that these later additions invalidated the *entire* original act? We think not. Since the original act was valid, the subsequent amendments, if unconstitutional, may be severed from the original act which remains valid.

In *Johnson Bros. Wholesale Liquor Co. v. Commissioner of Revenue*, 402 N.W.2d 791 (Minn. 1987), this court affirmed the tax court's use of a similar remedy in addressing a discriminatory tax on wine sales. *See id.* at 793. The *Johnson Bros.* court also observed that the United States Supreme Court has recognized that a withdrawal of benefits from the favored class is an acceptable remedy for unconstitutional discrimination. *Id.* (citing *Iowa-Des Moines Nat'l Bank v. Bennett*, 284 U.S. 239, 247 (1931). In the case at bar, the trial court simply did not apply section 645.20. Section 645.20 indicates, however, subject to certain qualifications which are not applicable in this case, that if any provisions of a law is found to be unconstitutional, severance is mandatory and the remaining provisions are valid. Accordingly, this court concludes that the trial court abused its discretion in refusing to apply section 645.20 and is, therefore, reversed.

Respondents seek to avoid such a result by emphasizing that the Minnesota Department of Revenue has stipulated that it will not collect Minnesota bank taxes on interest earned from SUB's issued pursuant to Minn. Stat. § 136.31-38 or from IDB's issued prior to July 1, 1979. This stipulation arguably distinguishes the present case from *Johnson Bros.* wherein the Revenue Department actually

collected the back taxes from the unlawfully favored wineries. *See Johnson Bros.*, at 792.

Respondents cite *Allegheny Pittsburgh Coal Co. v. County Commissioner of Webster County*, 488 U.S. 336, 109 S. Ct. 633 (1989), as authority for the proposition that discriminatory taxation is not cured by raising a tax on someone else. However, they fail to point out that *Allegheny* was an equal protection property tax case presenting significant valuation problems and did not involve a statutory mandate such as Minn. Stat. § 645.20. Respondents also cite *Baccus Imports, Ltd. v. Dias*, 468 U.S. 263, 267-81 n.7 (1984), but again fail to discuss significant differences between that case and this one. In *Bacchus*, the State of Hawaii imposed a 20% excise tax on wholesale liquor, but exempted certain locally manufactured alcoholic beverages. Wholesalers of nonexempt beverages challenged the tax as violative of the commerce clause. In the footnote cited by respondents, the United States Supreme Court noted that the severance issue was not presented to the Supreme Court of Hawaii in the case below and merely commented in passing that "severance" would not relieve the harm inflicted. *Bacchus*, 468 U.S. at 267-68 n.7.

The recent decision in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, ___ U.S. ___, 58 U.S.L.W. 4665 (June 4, 1990), makes clear that a state may cure the invalidity of a discriminatory tax by assessing and collecting back taxes from those who benefited from the discrimination. *Id.* at 4671. Although the Court concluded in *McKesson* that, in commerce clause cases, a state that selects this remedy must *actually* impose a retroactive tax, that conclusion was premised on the fact that actual

collection is necessary in order to cure the comparative economic disadvantage caused by the discriminatory tax. *See id.* at 4671-72. The present case is distinguishable from *McKesson* because there is no need to remedy any comparative economic disadvantage. Accordingly, we hold that severing the invalid exemptions renders the bank excise tax non-discriminatory and thereby satisfies the due process requirement of a fully adequate post-deprivation remedy.

More fundamentally, even if actually collecting the tax is a prerequisite to curing the constitutional infirmity of the tax in question, respondents do not explain where the Revenue Department gets the authority to limit this court's power to fashion an appropriate remedy for an unconstitutional tax. *See Amundson v. Cloverleaf Memorial Park Ass'n*, 221 Minn. 353, 358, 22 N.W.2d 170, 172 (1946) (suggesting that mistake and lack of authority are grounds for relieving a party from a stipulation).[6] Were it not for our conclusion that the *Memphis Bank* case established a new principle of law that was not clearly foreshadowed, we would order the Revenue Department to assess and collect the tax attributable to the state obligation interest income. We believe that ordering actual collection of the tax in this case would unfairly penalize both parties for failing to foresee the change in the law brought about in *Memphis Bank*. Consequently, we reject

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[6] When confronted with similar options, the Nebraska Supreme Court also chose to sever the unconstitutional exemptions. *State ex rel. Douglas v. Karnes*, 216 Neb. 750, 760, 346 N.W.2d 231, 236 (1984).

the respondents' contention that the actual imposition of back taxes is necessary in this case.

An additional reason for reversing the trial court is that it inappropriately applied the *Memphis* decision retroactively. The three factors governing non-retroactive application of judicial decisions were set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), as follows:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, it has been stressed that "we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." Finally, we have weighed the inequity imposed by retrospective application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity."

Id. at 106-07 (citations omitted). Applying these factors to the present case, we conclude that the decision in *Memphis* should be given prospective application only.

First, since the legislature passed the first state obligation interest exemption to the bank franchise tax in 1957, more than *20 years* elapsed before these taxpayers questioned the validity of this exemption. Yet, respondents argue that the *Memphis* case should be applied retroactively because it was not, they aver, a case deciding an

issue of first impression whose resolution was not clearly foreshadowed. The fact that this case was not brought until immediately after the *Memphis* case was decided, however, completely eviscerates the argument that the *Memphis* decision was clearly foreshadowed.

Second, the primary purpose of section 3124 is to protect the borrowing power of the United States Government. *See Memphis Bank*, 459 U.S. at 396 (referring to the congressional intent to prevent taxes which diminish the value of United States obligations). Respondents have not explained how the borrowing power of the United States will be protected by allowing them to receive multi-million dollar refunds. It seems to us that the purpose of promoting investments in United States obligations and protecting the borrowing power of the United States Government will be just as adequately advanced by prospective application as it will by retroactive application. This is especially true given that, soon after *Memphis Bank* was decided, the Minnesota Legislature met and repealed the disputed exemptions for Minnesota obligations. Act of May 20, 1983, ch. 213, 1983 Minn. Laws 613, 613-25.

Finally, in weighing the equities involved in this case, it is obvious that retroactive application of the *Memphis Bank* decision would cause a hardship to the State of Minnesota. The excise taxes in question have long since been spent by the state in providing, among other things, regulatory and other public services for all taxpayers, including the respondent banks. *See First Nat'l. Bank of Fredericksburg v. Commonwealth*, 553 A.2d 937, 947 (Pa. 1989) (Larsen, J., dissenting). By comparison, no equivalent hardship results to the banks by a prospective application of the decision in *Memphis Bank*. On the contrary,

respondents' taxes were actually reduced during the years the state obligation interest exemptions were mistakenly in effect. If the *Memphis Bank* decision is applied retroactively, respondent banks will have operated essentially tax-free during the period in question and would receive a refund of taxes that were, in effect, paid by others. Such a result would provide respondent banks with an undeserved windfall. As corporate citizens, these banks should not be allowed to enjoy the benefits of the privilege of doing business in the State of Minnesota without paying taxes.

In construing the very same issue, the Oklahoma Supreme Court in *First of McAlester Corp. v. Oklahoma Tax Commission,* 709 P.2d 1026 (Okla. 1985), also decided that *Memphis Bank* should be applied prospectively only. The *McAlester* court stated:

> It is arguable that previous case law foreshadowed the *Memphis Bank* pronouncement. It is equally persuasive that the type of bank tax in question might reasonably have been assumed to be constitutional based on the longstanding and widespread practice of various states to which the United States Supreme Court had not specifically spoken.
>
> * * * *
>
> Although the *Memphis Bank* case does not involve a reversal of a United States Supreme Court decision as in *Texas Company,* it does decide a new principle of law. * * *
>
> Although the new principle of law established in *Memphis Bank* might be characterized as merely a progression from former decisions,

> it was not foreseen by the Commission, nor by the Oklahoma Legislature.

Id., at 1034-36. We believe that the position of the Oklahoma court is sound. *See also American Trucking Ass'ns, Inc. v. Smith*, ___ U.S. ___, 58 U.S.L.W. 4704 (June 4, 1990) (applying the *Chevron Oil* test in upholding the Arkansas Supreme Court's prospective application of a United States Supreme Court decision which established a new principle of law).

For all of the above reasons, the trial court is reversed in its finding that the Minnesota bank franchise tax is an income tax and in the remedies it imposed. Respondents' request for refunds is denied in all respects.[7]

KELLEY, Justice (concurring specially)

I concur in the result; although I do not join that part of the opinion that purports to hold that the banks should be estopped from challenging the constitutionality of the bank tax.

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[7] Because of our other rulings in this case, we need not decide the issue of whether the trial court erred in refusing to reduce the ordered tax refunds by amounts allegedly allocable to the production of the interest income.

STATE OF MINNESOTA DISTRICT COURT
COUNTY OF RAMSEY SECOND JUDICIAL DISTRICT
CASE TYPE: OTHER CIVIL

Cambridge State Bank, et al.,

Plaintiffs,

vs.

File No. 469151

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

File No. 469547

vs.

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER ON PHASE I LIABILITY

These consolidated cases came on for trial before The Honorable Harold W. Schultz, Judge of the District Court,

on October 31, November 5, 6, 7, 12, 13, 14, and 17, 1986, in Courtroom 1315, Ramsey County Courthouse, St. Paul, Minnesota.

CHRISTOPHER J. DIETZEN, ESQ., and ANDREW J. MITCHELL, ESQ., of the law firm of LARKIN, HOFFMAN, DALY & LINDGREN, LTD., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, appeared representing Plaintiffs Cambridge State Bank, et al.

JAMES P. MC CARTHY, ESQ., and LAURENCE R. WALDOCH, ESQ., of the law firm of LINDQUIST & VENNUM, 4200 IDS Center, Minneapolis, Minnesota 55402, appeared representing Plaintiffs Cambridge State Bank, et al.

ROBERT L. SCHNELL, JR., ESQ., of the law firm of FAEGRE & BENSON, 2300 Multifoods Tower, Minneapolis, Minnesota 55402-3694, and WALTER A. PICKHARDT, ESQ., of the law firm of FAEGRE & BENSON, Suite 1150, 8400 Tower, 8400 Normandale Lake Boulevard, Bloomington, Minnesota 55437-1076, appeared representing Plaintiff Norwest Bank Duluth.

THOMAS R. MUCK, ESQ., Deputy Attorney General, and JAMES W. NEHER, ESQ., Special Assistant Attorney General, Second Floor, Centennial Office Building, St. Paul, Minnesota 55145, appeared representing the Defendants.

Court File No. 469151 was commenced by over 170 banks who are seeking tax refunds from the State of Minnesota for alleged over-payment of taxes in the years 1979 to 1983. Court File No. 469547 involves a similar

claim on behalf of the Norwest Bank Duluth for the year 1979. The Court is informed that there are other cases pending in other jurisdictions within the State of Minnesota involving the same issues.

By agreement of counsel and order of this Court, this case was bifurcated into separate trials on the issues of liability and damages. These Findings and Conclusions concern the liability portion of the trial.

By further agreement of counsel and order of this Court the matter was presented on a test case basis. Evidence was presented by four banks for the 1979 tax year. The four banks were: The Cambridge State Bank, Midway National Bank of St. Paul, First Security State Bank of Sleepy Eye, and Norwest Bank Duluth. The parties agreed that the conclusion of the Court on the liability phase would be conclusive as to all tax years at issue and all of the plaintiff banks.

Prior to the commencement of trial both parties submitted motions in limine. The plaintiffs moved for summary judgment on liability or, in the alternative, for an order to exclude certain evidence as irrelevant. The defendants moved for leave to amend their answers to assert an additional affirmative defense and for dismissal of the plaintiffs' complaints. After consideration, this Court granted the defendants' motion for leave to amend and denied all other pretrial motions. At the same time, this Court ruled that the defendants had the burden of establishing as affirmative defenses their claim with respect to the so-called issues of "comparability" and "de minimis impact."

At the inception of the trial the parties submitted a Stipulation of Facts (Plaintiffs' Exhibit 1) and attached exhibits (Plaintiffs' Exhibit 2) which were received into evidence. Based on those submissions, plaintiffs rested.

Thereafter, defendants presented their testimony on the affirmative defenses mentioned above. Defendants' witnesses were Mr. Delos Steenson and Dr. Timothy J. Nantell. Plaintiffs presented rebuttal testimony from Dr. Sung Won Sohn, Dr. John H. Kareken, and Dr. David Wyss. After defendants' rebuttal testimony from Dr. Nantell, the trial concluded.

Having heard the testimony presented, and upon all of the evidence, files, records, and proceedings herein, the Court makes the following Findings of Fact, Conclusions of Law, and Order.

INITIAL FINDINGS

1. Several of the Findings of Fact that follow are summaries of facts detailed in the Stipulation of Facts. (*See* Plaintiffs' Exhibits 1 and 2.) All facts stipulated to in those two exhibits are explicitly found to be facts by this Court, although they will not be recited individually here in the interests of readability and brevity.

2. Each of the plaintiff banks paid taxes to the State of Minnesota for the tax year 1979 pursuant to Minn. Stat. § 290.361. (Stipulation of Facts, paragraph 1.)

3. Pursuant to statute, the measure of the tax paid by these banks included interest income earned on obligations of the United States Government. These obligations included U.S. Treasury Notes, U.S. Treasury Bills,

U.S. Treasury Bonds, and obligations from various federal agencies including:

Federal Land Bank
Federal Home Loan Bank
Federal Farm Credit Bonds
Federal Credit Savings Bank
Farmers Home Administration Notes
World Bank Bonds
Bank For Cooperatives
Federal Home Loan Banks
Federal National Mortgage Association
Government National Mortgage Association

(Stipulation of Facts, paragraphs 3 and 5.)

4. Pursuant to statute, the measure of the tax paid by these banks did not include interest income earned by the banks on State University Board Bonds (SUB's) and Industrial Development Bonds (IDB's) issued by municipalities in the State of Minnesota. (Stipulation of Facts, paragraph 4.)

5. Also exempted from inclusion in the measure of the state bank taxes paid by the plaintiffs was interest earned on the following obligations of agencies of the State of Minnesota:

Minnesota Higher Education Coordinating Board Bonds
Minnesota Higher Education Facilities Authority Bonds
Metropolitan Transit Commission Bonds
Public Water and Sewer Bonds
Hospital District Bonds
Hospital Revenue Bonds
St. Cloud Transit Commission Bonds
Metropolitan Waste Control Commission Bonds

Housing Redevelopment Authority Bonds
Area Redevelopment Agency Bonds
Minnesota State Armory Commission Bonds
Solid Waste Management District Bonds

6. The Plaintiffs filed timely protective claims for refunds for the tax year 1979. (Stipulation of Facts, paragraph 2.)

7. The plaintiffs in both of these consolidated actions timely filed these actions for refunds.

8. There is no economic difference between the Minnesota bank tax imposed by Minn. Stat. § 290.361, which is labelled an "excise" tax measured by net income, and a tax that is imposed directly on net income such as the federal income tax.

INITIAL CONCLUSIONS OF LAW

9. During the 1979 through 1983 calendar years, the imposition of the Minnesota bank tax, pursuant to Minn. Stat. § 290.361, on interest received or accrued from obligations of the United States and its agencies was discriminatory because interest received or accrued from certain obligations of the State of Minnesota, its political subdivisions, and its instrumentalities was exempt from the tax. *Cf. Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392, 74 L. Ed. 2d 562, 103 S. Ct. 692 (1983).

10. Inasmuch as the Minnesota bank tax was discriminatory during the 1979 through 1983 calendar years, it was unlawful under the provisions of 31 U.S.C. § 742 (currently codified at 31 U.S.C. § 3124(a)) and under the Supremacy and Borrowing Clauses of the United States

Constitution. *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392, 74 L. Ed. 2d 562, 103 S. Ct. 692 (1983).

11. The Minnesota bank tax imposed by Minn. Stat. § 290.361, although labelled an "excise" tax, is a direct tax on net income for purposes of federal statutory and constituional law. *Cf. Complete Auto Transit v. Brady,* 430 U.S. 274, 51 L. Ed. 2d 326, 97 S. Ct. 1076 (1977) (the constitutionality of a state tax depends upon its actual economic consequences, not upon the label given to it by the state).

12. Inasmuch as the Minnesota bank tax is an income tax rather than a franchise tax, it was unlawful under the provisions of 31 U.S.C. § 742 (currently codified at 31 U.S.C. § 3124(a)) and under the Supremacy and Borrowing Clauses of the United States Constitution during the 1979 through 1983 calendar years. *Cf. Federal Products Corp. v. Norberg,* 429 A.2d 447 (R.I. 1981).

13. Defendants are liable to plaintiffs for refunds attributable to Minnesota bank taxes paid with respect to interest received or accrued on obligations of the United States and its agencies in amounts to be determined in a separate trials [sic] on the issue of damages.

BACKGROUND TO ADDITIONAL FINDINGS OF FACT AND CONCLUSION OF LAW

The State of Minnesota acknowledges that Minnesota's bank tax treats interest earned on certain state obligations more favorably than it does interest earned on federal obligations. Nevertheless, the state argues that the tax is not unconstitutional. It presents three arguments in support of its position. The first is that the state obligations given preferential treatment under the state tax are

not sufficiently "comparable" to federal obligations to establish discrimination. Second, the state argues that the preferential treatment of certain state obligations has little or no effect on the cost of borrowing by the federal government and, consequently, the preferential treatment is of no legal consequence. Finally, the state argues that the plaintiff banks are estopped from making these claims because they received the benefits of the provision they now claim to be unconstitutional. These defenses are referred to as the "comparability," "de minimis impact," and "estoppel" defenses.

As mentioned previously, the plaintiffs moved at the inception of the trial for a ruling as a matter of law that none of these three defenses was legally cognizable. The Court denied those motions prior to trial and allowed the defendant to present testimony in support of these defenses. The Court felt that this case would be more appropriately structured for review by an appellate tribunal if these three defenses would receive a full and complete hearing. Based on all of the evidence presented by both sides, the Court makes the following additional Findings of Fact and Conclusions of Law.

ADDITIONAL FINDINGS OF FACTS CONCERNING THE AFFIRMATIVE DEFENSES

A. "Comparability."

14. The obligations of the federal government and the exempted state obligations (*See* Findings 3 and 4 above) are similar in that they all are:

(a) Debt instruments. (Tr. Vol. I at 48.)

(b) With fixed periods of repayment. *Id.*

(c) With fixed interest rates *Id.* at 47

(d) With the payor of the obligation identified in the instrument. *Id.*

(e) With the principal amount of the debt fixed. *Id.*

(f) With the right in the bearer to resell them. *Id.* at 47.

(g) Issued by governmental agencies. *Id.*

(h) Issued pursuant to and in compliance with specific statutory authorization. *Id.*

(i) And, in the case of Federal Farm Credit Obligation and IDB's, both are used to provide low cost financing for statutorily approved purposes and both depend on repayment of debts by the beneficiary of the low cost financing. (Tr. Vol. I at 91-92.)

15. State obligations, including some IDB's, compete with some treasury obligations for investor dollars. (Tr. Vol. I at 46-47.)

16. Investors in debt instruments compare many different characteristics of those instruments in making their investment choices. (Tr. Vol. I at 46 and 48.) Among those are the characteristics of risk and liquidity. *Id.*

17. Obligations of the United States Treasury are generally considered to be of low risk and high liquidity. (*See* Defendants' Exhibit 1.)

18. Some IDB's are likewise considered to be of low risk and high liquidity. Indeed, some IDB's are perceived as being less risky and as liquid as certain of the non-

treasury obligations of the federal government. (Tr. Vol. I at 63-66 and 70.)

19. Differences in risk, as well as in other characteristics, tend to be reflected in the prices of a bond. (Tr. Vol. I at 61.) The issuers of bonds which may be perceived as risky tend to offer higher interest rates than do issuers of bonds of less risk and greater liquidity. *Id.* This price adjustment allows for competitive comparisons of obligations with different characteristics.

20. To the extent that the obligations of the State of Tennessee and its political subdivisions are comparable to federal obligations, Minnesota obligations are likewise comparable. (*See* Plaintiffs' Exhibit 2, attachments N and P.)

B. "De Minimis Impact."

21. The exemption granted to certain state obligations under the Minnesota Bank Tax caused the interest rate for those obligations to be lower than they would have been without the exemption. [Plaintiffs' Exhibit 6, at 8 (Nantell), Tr. Vol. II at 10 (Sohn), Tr. Vol. III at 153 (Kareken).] Investors who are interested in after tax return can get a competitive return on bonds bearing lower interest if they are also granted a tax exemption on the interest earned from those bonds. [Tr. Vol. II at 14, 30-31 (Sohn), Tr. Vol. IV at 7 (Kareken), Tr. Vol. V at 37-38 (Wyss).]

22. Because the tax exemption allows these obligations to carry lower interest rates, the demand for this

type of credit among borrowers was higher than it would have been without the exemption. *Id.*

23. This phenomenon alone increases the interest rates on certain federal obligations. [Tr. Vol. IV at 17-19 (Kareken), Tr. Vol. V at 16-18 (Wyss).]

24. Moreover, the evidence established that as a result of lower interest rates on the tax exempt bonds there was a net increase in the amount of borrowing over that which would have existed without the exemption. [Tr. Vol. II at 17 (Sohn) and, *e.g.*, Tr. Vol. V at 31 (Wyss).] This is pictorially represented on the supply/demand curves introduced at trial. (*See e.g.* Plaintiffs' Exhibit 7.)

25. The net increase in borrowing caused by the tax exemptions at issue here increased the competition among all borrowers, raising the cost to all borrowers, including the federal government. [Tr. Vol. II at 17 (Sohn), Tr. Vol. V at 33-35 (Wyss).]

26. Credible testimony established that the tax exemption under consideration here resulted in additional credit demands for IDB's of approximately thirty percent (30%) for general development bonds and up to eighty percent (80%) for pollution control and nonprofit IDB's. (*See* Plaintiffs' Exhibit 17 at 2-4.) On a national basis, the thirty percent (30%) additionality for industrial bonds translates to an additional $6 billion of credit demand annually. [Tr. Vol. V at 33-34 (Wyss).] The result of such an addition to the competition for credit on the federal government would be to increase federal borrowing costs approximately $1.75 billion. [Tr. Vol. V at 35 (Wyss).]

27. The preferential treatment by the state of various of its obligations burdened the holders of federal obligations. The result was that the cost of borrowing by the federal government was higher than it would have been without the preferential treatment. [Tr. Vol. II at 12 and 17 (Sohn), Tr. Vol. III at 159 (Kareken), and Tr. Vol. V at 37-44 (Wyss).]

C. "ESTOPPEL."

28. The plaintiffs, by availing themselves of the tax exemption granted by the state on certain of its obligations, did not claim any benefits under the portion of the tax code asserted by plaintiffs to have been unconstitutional.

ADDITIONAL CONCLUSIONS OF LAW CONCERNING THE AFFIRMATIVE DEFENSES

A. "Comparability."

29. This Court concludes as a matter of law that the state obligations which received preferential treatment by the State of Minnesota are, for the purposes of the constitutional and statutory analysis required under *Memphis Bank,* otherewise [sic] comparable to federal obligations.

B. "DE MINIMIS IMPACT"

30. This Court further concludes that preferential treatment of state obligations is, on its face, discrimination. It would be of no legal significance had the state succeeded in establishing that the economic incident of that discrimination was minute or even nonexistent. To

protect the constitutional principle at issue, it is enough that there be facial discrimination.

31. Moreover, the evidence clearly established that the discriminatory taxing scheme used by the State of Minnesota, if likewise used by all fifty states, would cause the interest rates paid by the federal government in support of its debt to rise. The economic incidence of this discrimination would be far from de minimis, reaching into the billions of dollars of increased federal expense.

C. "The Estoppel Defense."

32. The plaintiffs are not estopped from bringing this claim for refund. The theory of estoppel upon which the defendant relies is no longer the law in the State of Minnesota. *See Wegan v. Village of Lexington*, 309 N.W.2d 273, 277 (Minn. 1981); *Haugen v. Town of Walthen*, 292 N.W.2d 373 (Minn. 1980); *Werner v. Olmstead County*, 290 N.W.2d 444 (Minn. 1980). Moreover, factually the theory is simply inapplicable since plaintiffs did not benefit from the provisions they claim are unconstitutional.

33. All of the foregoing Findings of Fact may, if deemed more appropriate, be considered Conclusions of Law and vice versa.

* * *

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that the defendants are adjudged liable to the plaintiffs for tax refunds in amounts to be determined in Phase II of this proceeding.

Dated at St. Paul, Minnesota, this 20th day of May, 1987.

/s/ Harold W. Schultz
HAROLD W. SCHULTZ
JUDGE OF THE DISTRICT COURT

MEMORANDUM

This Court feels that an extensive memorandum quoting cases, statutes, etc., is unnecessary. The attorneys involved in this case did an exceptionally able job of preparing and presenting this case.

First of all, counsel had stipulated as to certain facts, had taken depositions, and had briefed the various issues to a point where the trial went exceptionally smooth.

Counsel presented to the Court motions which, as far as the plaintiffs were concerned, would have disposed of the case much in the manner of a summary judgment. While the arguments on the part of plaintiffs were reasonably persuasive, the Court felt that there was a danger that if the case were disposed of on that basis it could be suggested that ample opportunity to raise factual issues and defenses had not been given to the defendants. Therefore, the Court denied the motions for summary judgment and granted the defendants' motions for a hearing on the various items that defendants felt were proper defenses to plaintiffs' claims. A substantial amount of time was given to the defendants to present the testimony of experts dealing with the questions of comparability and de minimis impact.

The argument with respect to the estoppel agreement was a legal argument not requiring any testimony.

The testimony of the expert witnesses was produced and heard by the Court in an expeditious manner. However, a complete hearing was given to the defendants with respect to these issues. Unfortunately, neither the

testimony of the witnesses nor the law provide any comfort to the position taken by the defendants. This Court was convinced beyond any doubt that the plaintiffs must prevail in this matter.

A careful reading of the Supreme Court with respect to the Memphis Bank and Trust Company case leads the Court to the conclusion that the Minnesota and Tennessee situations for all practical purposes are identical. The burden of proof which the state had with respect to the comparability defense was not met and the Court has concluded that on that defense the state does not prevail.

The Court further adopts the position taken by plaintiffs that the important aspect for the Court in this matter was discrimination rather than impact. It goes without saying that the Court found discrimination and sufficient impact. The state did not establish that the effect of its discriminatory tax had only a de minimis impact.

It should be noted that counsel have suggested that the policy questions and the complexity of the issues herein dictate that this matter be reviewed by the appellate system in the State of Minnesota and possibly even in the federal courts. For that reason the Court feels that the record provides an ample basis for any appellate review.

The Court feels that it would be redundant to restate the facts as set out in the Findings of Fact, Conclusions of Law, and Order. This matter has been well tried, carefully considered, and the conclusion as stated in the Court's order is, in the opinion of the Court, the only conclusion possible based on the facts and the law.

/s/ Schultz, J.
Schultz, J.

CASE TYPE: OTHER CIVIL

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN SECOND JUDICIAL DISTRICT

Cambridge State Bank, et al.,

Plaintiffs,

vs.

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

File No. C1 84 469151

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

vs.

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

File No. C4 84 469547

FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER ON PHASE II – REFUNDS

These consolidated cases came on for trial before The Honorable Harold W. Schultz, Judge of the District Court, on February 27 and 28, 1989, in Courtroom 1531, Ramsey County Courthouse, St. Paul, Minnesota.

ROBERT L. SCHNELL, JR., ESQ., of the law firm FAEGRE & BENSON, 2200 Norwest Center, Minneapolis, Minnesota 55402, and WALTER A. PICKHARDT, ESQ., of the law firm of FAEGRE & BENSON, Suite 1150, 8400 Tower, 8400 Normandale Lake Boulevard, Bloomington, Minnesota 55437-1076, appeared representing Plaintiff Norwest Bank Duluth.

ANDREW J. MITCHELL, ESQ., of the law firm of LARKIN, HOFFMAN, DALY & LINDGREN, LTD., 1500 Northwestern Financial Center, 7900 Xerxes Avenue South, Bloomington, Minnesota 55431, appeared representing Plaintiffs Cambridge State Bank, et al.

THOMAS L. FABEL, ESQ., of the law firm of LINDQUIST & VENNUM, 4200 IDS Center, Minneapolis, Minnesota 55402, appeared representing Plaintiffs Cambridge State Bank, et al.

THOMAS R. MUCK, ESQ., Deputy Attorney General, and BARRY GRELLER, ESQ., Special Assistant Attorney General, Tax Litigation Division, 10 River Park Plaza, Mail Station 0600, St. Paul, Minnesota 55146, appeared representing the Defendants.

By agreement of counsel and order of this Court, this case was bifurcated into separate trials on the issues of

liability and damages. In Phase I of the case, the Court held that the Minnesota bank tax (Minn. Stat. §290.361) unlawfully discriminated against Federal obligations during the period 1979 through 1983 in violation of Federal law, 31 U.S.C. §742. The Court also held that the Minnesota bank tax, although labelled an "excise" tax, was an income tax for purposes of Federal statutory and constitutional law, and that this also made the Minnesota bank tax unlawful under 31 U.S.C. §742. The Court held that Defendants were liable to Plaintiffs for refunds in amounts to be determined at Phase II of the trial. These Findings and Conclusions concern Phase II, the refund portion of the trial.

By further agreement of counsel and order of this Court, the matter was presented on a test case basis. Evidence was presented by four banks (the "Test Banks") for the 1979 tax Year. The four banks were: Cambridge State Bank ("Cambridge"), Midway National Bank of St. Paul ("Midway"), First Security State Bank of Sleepy Eye ("Sleepy Eye"), and Norwest Bank Duluth ("Norwest"). The parties agreed that the conclusion of the Court on the refund phase would be conclusive as to all tax years at issue and all of the Plaintiff banks.

Prior to the commencement of trial, the parties submitted motions *in limine*. The Plaintiffs moved for summary judgment on certain issues or, in the alternative, for an order to exclude certain evidence as irrelevant. The Defendants also submitted motions for summary judgment. The Court heard arguments regarding all motions on January 20, 1989.

Plaintiffs' first motion requested partial summary judgment dismissing Defendants' contention that discrimination against Federal obligations should be cured by invalidating all statutes favoring state bonds. Defendants' second motion requested summary judgment in favor of invalidating such statutes, which would result in the removal of the tax-exempt status of such bonds. At the commencement of trial, the Court granted Plaintiffs' first motion and denied Defendants' second motion. A Conclusion of Law to this effect is included below in paragraph 31. The Court held that discrimination against Federal obligations would not be cured by retroactively invalidating the tax-exempt status of state bonds because, in actual fact, such bonds were tax-exempt in 1979 and the Department of Revenue has not collected (and by stipulation will not collect) tax on such bonds. Thus, granting Defendants' second motion would, in substance and effect, uphold the unconstitutional discrimination against Federal obligations and deny Plaintiffs a remedy.

Plaintiffs' second motion requested partial summary judgment dismissing the contention of Defendants' that *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983), be applied on a prospective-only basis. In the alternative, Plaintiffs' moved for the exclusion of the testimony of Mr. Oja Ena with respect to the prospectivity issue. This latter motion was denied, and Mr. Ena's testimony was received. Defendants' third motion requested summary judgment that the *Memphis Bank* case should be applied on a prospective-only basis. Defendants also moved in their first motion for summary judgment that the Court's ruling holding the Minnesota bank to be an income tax should be applied on a prospective-only basis. Having

received the testimony of Mr. Ena on these issues, the Court hereby denies all motions on prospectivity issues, which instead will be considered upon all of the evidence received.

Plaintiffs' third motion asked for summary judgment that their interest deductions should be allowed as a matter of law pursuant to Minn. Stat. §290.09, subd. 3. Defendants filed a cross-motion for summary judgment on this issue. Plaintiffs, as an alternative, requested that the testimony of Mr. Larry D. Fredricks, a witness for Defendants, be excluded. The Court denied this latter motion and received the testimony of Mr. Fredricks. The Court also received the testimony of Plaintiffs' witnesses, Mr. Philip D. Rolle and Mr. Lloyd A. Amundson, on this issue. Inasmuch as both parties have introduced testimony on the issue of whether interest deductions should be disallowed, the Court hereby denies all motions on this issue, which will instead be considered upon all of the evidence received.

At the inception of the trial of Phase II, the Parties submitted a Statement of Position and Stipulation of Facts (Phase II) and attached exhibits (Plaintiffs' Exhibit 21) which were received into evidence. Thereafter, the Plaintiffs called as witnesses Mr. Rolle and Mr. Amundson, who testified regarding the investment activities, operations and expenses of banks. Defendants called Mr. Fredricks, who testified regarding the same issues, and Mr. Ena, who testified regarding the financial impact to the State of Minnesota in the event refunds are awarded to all taxpayers who have relied on the *Memphis Bank* case in filing refund claims. The trial then concluded.

Having heard the testimony presented, and upon all of the evidence, filed, records, and proceedings herein, the Court makes the following Findings of Fact, Conclusions of Law, and Orders.

FINDINGS OF FACT

1. Several of the findings of fact that follow are summaries of facts detailed in the Statement of Position and Stipulation of Facts (Phase II) dated February 27, 1989 (the "Phase II Stipulation"), and exhibits thereto (*See* Plaintiffs' Exhibit 21). All of the facts stipulated to in the Phase II Stipulation are explicitly found to be facts by this Court, and are incorporated by reference, although they will not be recited individually here.

2. The Test Banks paid Minnesota bank taxes for 1979 in the following amounts: Norwest, $229,295 (Phase II Stipulation, ¶ 28); Sleepy Eye, $36,378.36 (Phase II Stipulation, ¶ 33); Cambridge, $23,933 (Phase II Stipulation, ¶ 38); Midway, $293,840 (Phase II Stipulation, ¶ 43).

3. The items of income, deduction and credit reported by each Test Bank on its Minnesota bank tax return for 1979 were accurate in amount. Such items were also properly reported for Minnesota bank tax purposes, except that (a) each Test Bank reported as taxable income interest earned on Federal obligations, which was held exempt from tax in Phase I of this case, and (b) because such interest was held to be exempt, certain deductions previously allowable became disallowable, as hereinafter described. (Phase II Stipulation, ¶'s 30, 35, 40 and 45.)

4. The Test Banks earned interest on Federal obligations in 1979 in the following amounts: Norwest, $1,599,288 (Phase II Stipulation, ¶ 30); Sleepy Eye, $348,577 (Phase II Stipulation, ¶ 35); Cambridge, $612,697 (Phase II Stipulation, ¶ 40); Midway, $393,125 (Phase II Stipulation, ¶ 45).

5. The Test Banks incurred investment operating expenses in 1979, which consisted of operating expenses associated with Test Bank investment functions insofar as they were allocable to Federal obligations. Investment operating expenses included salaries and fringe benefits paid during the 1979 taxable year to employees whose duties included investing in Federal obligations and monitoring such investments, and certain other expenses relating thereto, including: expenses for management fees, office supplies, postage, telephone, data processing and occupancy, as well as depreciation on furniture and equipment used by personnel performing the investment function. (Phase II Stipulation, ¶ 10.C.)

6. The Test Banks incurred investment operating expenses in 1979 in the following amounts: Norwest, $23,744; Sleepy Eye, $7,395; Cambridge, $12,318; and Midway, $5,009. (Phase II Stipulation, ¶ 10.D.) The Test Banks deducted such investment operating expenses in computing their respective liability for Minnesota bank tax.

7. There was a direct relationship between investment operating expenses and investment transactions. As the number of investment transactions increased or decreased, investment operating expenses increased or decreased. The reason for this is that there was a tie-in

between investment operating expenses, which represent the costs of actually making investments, and investment transactions. (Tr. Vol. I at 63-66 [Rolle].)

8. Investment operating expenses incurred and deducted by the Test Banks were connected with or allocable against interest earned on Federal obligations. (Phase II Stipulation, ¶ 10.B; Tr. Vol. I at 63 [Rolle]; Tr. Vol. I at 176-180 [Amundson].)

9. Banks have a legal obligation under their charters to accept deposits. (Tr. Vol. I at 66 [Rolle]; Tr. Vol. I at 187-88 [Amundson].) Banks can indirectly affect the amount of funds deposited by customers by setting interest rates paid on deposits and by advertising. However, banks cannot control the amount of deposits. (Tr. Vol. I at 67-72 and 115 [Rolle].)

10. Banks have a legal obligation under their charters and the Community Reinvestment Act to make loans. (Tr. Vol. I at 66 [Rolle]; Tr. Vol. I at 187-188 [Amundson].) Banks can indirectly affect the demand for loans by setting interest rates charged on loans and by advertising. However, banks cannot control the demand for loans by credit-worthy borrowers. (Tr. Vol. I at 72-76 and 115-116 [Rolle].)

11. If a bank does not have sufficient demand for loans, it may attempt to discourage a customer from depositing funds by suggesting that the customer purchase a Federal obligation, which can be sold to the customer by the bank. (Tr. Vol. I at 87-88 [Rolle].)

12. If a bank has deposits in excess of loans, because of an insufficiency in loan demand, the bank may "warehouse" its excess funds. In other words, it may invest its excess funds until an opportunity to lend the funds arises. Banks sometimes "warehouse" excess funds by Purchasing Federal obligations. (Tr. Vol. I at 76-79 and 116 [Rolle]; Tr. Vol. I at 191-192 [Amundson].)

13. Banks do not accept deposits for the purpose of warehousing funds. (Tr. Vol. I at 129 [Rolle]; Tr. Vol. I at 192 [Amundson].)

14. Banks sometimes use Federal obligations to provide liquidity. (Tr. Vol. I at 138-139 [Rolle]; Tr. Vol. I at 188 [Amundson].) However, they are not obligated to use Federal obligations to provide liquidity and commonly use other kinds of securities for this purpose. (Tr. Vol. I at 139-140 [Rolle].)

15. Banks do not accept deposits for the Purpose of creating liquidity through the purchase of Federal obligations. (Tr. Vol. I at 189 [Amundson].)

16. Banks sometimes use Federal obligations to meet pledging requirements if a state or local government deposits funds in excess of $100,000. (Tr. Vol. I at 189-190 [Amundson].)

17. Banks do not accept deposits requiring pledged assets for the purpose of purchasing Federal obligations. (Tr. Vol. I at 190 [Amundson].)

18. Each of the Test Banks incurred (and deducted for Minnesota bank tax purposes) cost-of-money operating expenses in 1979. Cost-of-money operating expenses included salaries and fringe benefits paid to employees

engaged in the fund providing functions of a bank (i.e., those functions by which deposits and other funds are brought into a bank), including bank tellers, employees in checking operations, and employees engaged in acquiring equity capital and funds through long-term debt. Cost-of-money operating expenses also included expenses for office supplies, postage, telephone, advertising, travel, data processing and equipment and certain other expenses, all to the extent allocable to fund-providing functions. (Phase II Stipulation, ¶ 11.A.)

19. There was no relationship between cost-of-money operating expenses of the Test Banks and interest they earned on Federal obligations. For example, cost-of-money operating expenses of a bank might increase while its interest income from Federal obligations decreased, or vice versa. Increases and decreases in cost-of-money operating expenses occurred independently of increases and decreases in income from Federal obligations. (Tr. Vol. I at 79-83 and 116-117 [Rolle]; Tr. Vol. I at 182-185 [Amundson].)

20. Cost-of-money operating expenses incurred and deducted by the Test Banks were not connected with or allocable against interest earned on Federal obligations. (Tr. Vol. I at 60-61 [Rolle]; Tr. Vol. I at 182 and 198 [Amundson].)

21. Each of the Test Banks incurred and deducted interest expense in 1979. (Phase II Stipulation, ¶'s 12-15.)

22. With the exception of interest paid by Norwest and Cambridge on capital notes, all interest deducted by the Test Banks was paid or accrued on short-term borrowings incurred by the Test Banks in the ordinary course

of their banking business including: savings accounts, savings certificates, certificates of deposit, Federal funds purchased, repurchase agreements and Federal Reserve Bank borrowings. (Phase II Stipulation, ¶ 21.)

23. The borrowings described in paragraph 22 were incurred for the purpose of making loans. (Tr. Vol. I at 104 [Rolle]; Tr. Vol. I at 206 [Amundson].)

24. Norwest and Cambridge incurred interest expense on capital notes in 1979. The capital notes were issued for the purpose of increasing their capital and expanding their capacity to make loans. (Phase II Stipulation, ¶ 23.)

25. There was no direct connection between indebtedness incurred by a Test Bank and investments by a Test Bank in Federal obligations. (Phase II Stipulation, ¶ 24.)

26. There was no relationship between interest expense paid or accrued by the Test Banks and interest income earned by the Test Banks on Federal obligations. For example, interest expense of a bank might increase while its interest income from Federal obligations decreased, or vice versa. Increases and decreases in cost-of-money operating expenses occurred independently of increases and decreases in income from Federal obligations. (Tr. Vol. I at 83-86 [Rolle]; Tr. Vol. I at 186 [Amundson].)

27. The Test Banks did not incur or continue any indebtedness for the purpose of purchasing or carrying Federal obligations. (Tr. Vol. I at 62 [Rolle]; Tr. Vol. I at 186 [Amundson].)

28. The amount of refunds payable by the State of Minnesota to all taxpayers having claims similar to the Test Banks is speculative and has not been established.

29. Projections as of November, 1988, by the Minnesota Department of Finance establish that at June 30, 1989, which is the end of the current biennium, and through June 30, 1991, which is the end of the next biennium, the State of Minnesota will have sufficient funds in reserve to pay even the highest amount of refunds that might be due to all taxpayers as a result of this case. (Phase II Stipulation, Exhibit W, pages 24-26.)

30. For all tax years at issue through June 30, 1983, the Minnesota Department of Revenue did not collect, and has stipulated that it will not collect, Minnesota bank taxes on interest earned from State University Board Bonds issued pursuant to Minn. Stat. §136.31-38, or from Industrial Revenue Bonds issued prior to July 1, 1979, pursuant to Chapter 474 of the Minnesota Statutes, which was claimed as exempt income. (Phase II Stipulation, ¶ 58.)

CONCLUSIONS OF LAW

31. Unlawful discrimination by the State of Minnesota against Federal obligations cannot be cured by invalidating Minnesota Statutes favoring exempt State University Board Bonds, Industrial Revenue Bonds, or other exempt bonds.

32. This Court concludes that such unlawful discrimination must be cured by striking out language from Minnesota Statutes that caused Federal obligations to be

taxed. Accordingly, it is held that Subdivision 13 of Section 290.08 of Minnesota Statutes shall read as follows for the period 1979 through June 30, 1983, with the stricken language severed from the statute:

> Subd. 13. Certain exemptions inapplicable to corporations. Subdivisions 4, 5, 10 and 11 shall not apply to corporations and subdivisions 7 ~~and/8~~ shall not apply to corporations taxable under section 290.02 or under section 290.361.

33. The decision of the United States Supreme Court in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), was decided "under the principles established in [its] previous cases," as the Supreme Court stated in its opinion. 459 U.S. at 398. The Supreme Court did not establish a new principle of law in *Memphis Bank*.

34. Under principles set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), because the *Memphis Bank* case did not establish a new principle of law, *Memphis Bank* applies retroactively to the years at issue in this case.

35. The "new principle of law" test set forth in Chevron is a threshold test. Since *Memphis Bank* did not establish a new principle of law, it is unnecessary to apply to second and third *Chevron* tests. However, if it were necessary, the Court would hold that (a) the purpose and effect of *Memphis Bank* would best be served by retroactive application, and (b) retroactive application of *Memphis Bank* would not cause an inequitable result.

36. The Court also holds that *Memphis Bank* should be applied retroactively because the United States Supreme Court did not limit the effect of its decision to prospective-only application. *Cf. Welyczko v. U.S. Air, Inc.*,

733 F.2d 239 (2d Cir.), *cert. denied*, 469 U.S. 1036 (1984); *U.S. v. Fitzgerald*, 545 F.2d 578 (7th Cir. 1976).

37. This Court's holdings in Phase I of the case that the Minnesota bank tax was discriminatory and unlawful (Findings of Fact, Conclusions of Law, and Order on Phase I Liability, ¶'s 9 and 10), for which *Memphis Bank* is cited as authority, are also supported and compelled by the holding of the Minnesota Supreme Court in *State v. Duluth M. & N. Ry Co.*, 207 Minn. 618, 292 N.W. 401 (1939), *reh'g denied*, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1940).

38. This Court's holdings in Phase I of the case that the Minnesota bank tax was an income tax for Purposes of federal statutory and constitutional law, and was therefore unlawful (Findings of Fact, Conclusions of Law, and Order on Phase I Liability, ¶'s 11 and 12), was foreshadowed by *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), *reh'g denied*, 430 U.S. 976 (1977). These holdings did not establish a new principle of law. Accordingly, under *Chevron*, these holdings apply retroactively to the years at issue in this case.

39. Since this Court's holdings that the Minnesota bank tax is an income tax did not establish a new principle of law, it is unnecessary to apply the second and third *Chevron* tests. However, if it were necessary, the Court would hold that (a) the purpose and effect of the income tax holdings would best be served by retroactive application, and (b) retroactive application of the income tax rulings would not cause an inequitable result.

40. The Test Banks are entitled to refunds of Minnesota bank taxes for the 1979 test year.

41. In computing refunds due the Test Banks, interest earned on Federal obligations (see paragraph 4, supra) should be excluded from income. *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983); *State v. Duluth M. & N. Ry. Co.,* 207 Minn. 618, 292 N.W. 401 (1939), *reh'g denied,* 292 N.W. 411 (1940), *cert. denied,* 311 U.S. 719 (1940); 31 U.S.C. §742.

42. In computing refunds due the Test Banks, investment operating expenses deducted by the Test Banks (see paragraph 6, supra) should be added back to income. Investment operating expenses were connected with and allocable against Federal obligation interest income, and are thus disallowed as deductions pursuant to Minn. Stat. §290.10(9).

43. Because cost-of-money operating expenses were not connected with or allocable against interest earned on Federal obligations, the Test Banks' cost-of-money operating expense deductions are not subject to disallowance under Minn. Stat. §290.10(9).

44. The Court agrees with the parties that interest expense is connected with or allocable against Federal obligation interest (and that an interest deduction should be disallowed) only if the interest expense is paid or accrued on indebtedness incurred or continued to Purchase or carry Federal obligations. (Phase II Stipulation, ¶ 26.C.)

45. Because the Test Banks did not incur or continue indebtedness to purchase or carry Federal obligations, the Test Banks' interest expense deductions are not subject to disallowance under Minn. Stat. §290.09, Subd. 3, or Minn. Stat. §290.10(9). *Cf.* Rev. Proc. 70-20, 1970-2 Cum. Bull.

499; Rev. Rul. 61-62, 1961-2 Cum. Bull. 58; I.T. 2028, III-1 Cum. Bull. 296 (1924).

46. The Court agrees with the computations of refunds submitted by the Test Banks as set forth in Exhibits F, H, J and L to the Phase II Stipulation.

47. This matter was presented on a test-case basis. The *Norwest Bank Duluth* lawsuit encompassed only tax year 1979. The *Cambridge State Bank* lawsuit involved numerous banks and tax years 1979 through 1983. Since the parties agreed that the conclusion of the Court would be conclusive as to all tax years at issue and all of Plaintiff Test Banks, there is no just reason for delay of entry of judgment as to the tax refunds due for tax year 1979 to Cambridge, Midway and Sleepy Eye.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that Defendants are adjudged liable to the Plaintiff Test Banks for tax refunds in the following amounts: Norwest, $189,065; Sleepy Eye, $36,278; Cambridge, $23,833; Midway, $46,574. The Court orders further that interest be paid upon these amounts as required by law.

The Court further finds that there is no just reason for delay in entry of final judgment with respect to the tax refunds for tax Year 1979 for Norwest, Cambridge, Midway and Sleepy Eye. Accordingly, the Court expressly directs that judgment be entered immediately in accordance with this Order.

Dated at St. Paul, Minnesota, this ___ day of ___, 1989.

HAROLD W. SCHULTZ
JUDGE OF THE DISTRICT
COURT

CASE TYPE: OTHER CIVIL

STATE OF MINNESOTA DISTRICT COURT

COUNTY OF HENNEPIN SECOND JUDICIAL DISTRICT

Cambridge State Bank, et al.,

Plaintiffs,

vs.

Arthur C. Roemer, Commissioner, Department of Revenue, State of Minnesota,

Defendant.

File No. C1 84 469151

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Plaintiff,

vs.

Arthur C. Roemer, in his capacity as Commissioner of Revenue, and the State of Minnesota,

Defendants.

File No. C4 84 469547

MEMORANDUM

Phase II of the case before the Court was well prepared and tried by all counsel. The efforts on the part of counsel who tried to dispose of the matter by settlement are to be commended. However, because the matter could

not be disposed of by settlement, it was necessary for the Court to hold the hearing and to rule on the issues in Phase II of this case. Primarily, the only issue before the Court was question of damages as far as all of the Plaintiffs are concerned and it should be kept in mind that this is considered a test case in a matter of speaking and, therefore, figures for some of the other Plaintiff banks will have to be determined by counsel.

The key issue as far as the Court is concerned in this matter was whether or not the principles of law announced in the *Memphis Bank* case should be applied on a prospective basis or a retrospective basis. This matter was vigorously contested and the Court has determined that based on all of the law and the facts at hand, the liability against the State of Minnesota in this matter is to be applied retrospectively. It should be noted that in the *Memphis State Bank* case, the Supreme Court of the United States did not declare its determination as to retroactivity or prospectivity. As a matter of fact, the federal judicial system has indicated that that question is one of public policy and is to be determined by the respective states. It does appear that if the United States Supreme Court wanted this matter to be handled only prospectively, it would have declared so in its opinion. And also it was declared in the case of *Solum versus Stumer,* 104 Supreme Court 1338, 1341 (1984) that prospectively is only an exception to the general rule of retroactivity. Counsel have indicated that there is no clear cut precedent here in the State of Minnesota with respect to this question. The Court agrees. The only instance that counsel and Court were able to find were a similar question where a similar question was decided by one of our

neighboring states, is the matter of the case of *Burlington Northern, Inc., et al versus City of Superior, Wisconsin.* This was in the Court of Appeals, District Three for the State of Wisconsin. And further inquiry has determined that the Supreme Court of the State of Wisconsin has refused to review the matter, so the determination of the Court of Appeals stands.

In this case, the question of retroactivity involves taxes paid by the Plaintiffs to the City was determined in favor of the Plaintiffs.

Now that the Court has concluded that the law is to be applied retroactively, the next question to be determined was whether or not certain deductions were to take place in calculating the refund. The Court did not rule on any of the motions made with respect to the problem and allowed the testimony of two witnesses for the Plaintiffs and two witnesses for the State to assist the Court in determining this matter. After hearing the testimony of all of the witnesses, the Court has determined that the Plaintiff's position in this matter is the correct one and must stand. No further purpose would be served by going into ancillary problems or to reiterate cases that stand as foundation for the Court's Finding of Fact and Conclusions of Law.

/s/ HWS
Harold W. Schultz
Judge of the District Court

STATE OF MINNESOTA
IN SUPREME COURT

C0-89-2097

Cambridge State Bank, et al.,

Respondents,

vs.

John P. James, Commissioner, Department of Revenue, State of Minnesota,

Appellant,

and

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Respondent,

vs.

John P. James, in his capacity as Commissioner of Revenue, and The State of Minnesota,

Appellant.

ORDER

(Filed May 16, 1994)

Based upon all the files, records and proceedings herein,

IT IS HEREBY ORDERED that the petition for rehearing in the above entitled matter be, and the same is, denied.

Dated: May 12, 1994

BY THE COURT:

/s/ Sandra Gardebring
Associate Justice

STATE OF MINNESOTA

Cambridge State Bank, et al.,

Respondent,

vs

John P. James, Commissioner of Department of Revenue, State of Minnesota,

Appellant.

and

Norwest Bank Duluth, National Association (formerly First National Bank of Duluth),

Respondent,

vs

John P. James, in his capacity as Commissioner of Revenue, and The State of Minnesota,

Appellant.

[ ] Supreme Court

[ ] Court Of Appeals

JUDGMENT

C0-89-2097
Appellate Court Case Number

_____
Trial Court Case Number

Pursuant to an order of Court heretofore duly made and entered in this cause it is determined and adjudged that the judgment *of the Court below, herein appealed from, to wit, of the* District *Court within and for the County of* Ramsey *be and the same hereby is* affirmed and remanded *and that judgment be entered accordingly. A certified copy of the entry*

of judgment and the Court's decision is herewith transmitted and made part of the remittitur.

And it is further determined and adjudged that respondent, Norwest Bank Duluth *herein, do have and recover of* appellants *herein the sum and amount of* Six hundred and 00/100. . . . . *Dollars, ($* 600.00*) as costs and disbursements in this cause in this Court, and that execution may be issued for the enforcement thereof.*

Dated and signed: FOR THE COURT May 24, 1994

Attest: Frederick K. Grittner

Dated Clerk of the Appellate Courts

By: /s/ Julie Kurth
Deputy/Assistant Clerk

Statement For Judgment

Statutory Costs	$ 0.00
Printer	$ 0.00
Postage and Express	$ 0.00
Trial Court Fee	$ 0.00
Appellate Court Fee	$ 0.00
Transcript	$ 0.00
Appeal Bond	$ 0.00
Other Us Supreme Court orders	$600.00
Total	$600.00

Satisfaction of Judgment filed: _____
Dated

Therefore the above judgment is duly satisfied in full and discharged of record

Attest: Frederick K. Grittner
Clerk of the Appellate Courts
By: _____
Deputy/assistant Clerk

Minn. Stat. § 290.08 (1978) (Interest on federal obligations included in gross income for bank excise tax purposes).

> **290.08 EXEMPTIONS FROM GROSS INCOME.** Subdivision 1. **In general.** The following items shall not be included in gross income, provided that any item which was excluded in arriving at gross income under the provisions of section 290.01, subdivision 20, shall not be again excluded under this section.
>
> * * *
>
> Subd. 8. **Interest from United States.** Interest upon obligations of the United States, its possessions, its agencies, or its instrumentalities, so far as immune from state taxation under federal law. . . .
>
> * * *
>
> Subd. 13. **Certain exemptions inapplicable to corporations.** Subdivisions 4, 5, 10 and 11 shall not apply to corporations and subdivisions 7 and 8 shall not apply to corporations taxable under section 290.02 or under section 290.361.

Minn. Stat. § 290.361 (1978) (Minnesota Bank excise tax).

290.361 NATIONAL AND STATE BANKS; IMPOSITION OF EXCISE TAX, COMPUTATION, SURTAX. Subdivision 1. **Imposition of excise tax.** An excise tax measured by net income is hereby imposed on national and state banks by this chapter and shall be governed by the provisions of section 290.02.

* * *

Subd. 5 **In lieu of certain taxes.** The tax hereby imposed upon national and state banks shall be in lieu of all taxes upon the capital, surplus, property, assets, and shares of these banks, except taxes imposed upon real property.

Minn. Stat. § 136.32 (1978) (Tax exemption for interest on State University Board bonds).

136.32 BONDS, INVESTMENTS.

. . . All bonds issued under sections 136.31 to 136.38 shall be exempt from all taxation. Interest paid on such bonds shall not be included in gross income for the purpose of computing any tax imposed by or under any provisions of chapter 290, or any act amendatory thereof or supplemental thereto.

Minn. Stat. § 474.12 (Supp. 1979) (Tax exemption for interest on Industrial Development bonds).

474.12 Exclusion of interest on bonds from gross income.

Subdivision 1. Interest paid on bonds issued under authority of this chapter shall not be included in gross income for the purpose of computing any tax imposed by or under the provisions of chapter 290, or any act amendatory thereof or supplemental thereto.

Subd. 2. Notwithstanding subdivision 1, the interest paid on bonds issued under authority of this chapter and issued after June 30, 1979 shall be exempt only as provided under section 290.08, subdivision 7, for obligations of the issuing municipality.

Minn. Stat. § 271.01 (1978) (Minnesota tax court).

271.01 CREATION. Subdivision 1. **Membership, appointment, qualifications.** There is hereby created a tax court as an independent agency of the executive branch of the government. . . .

* * *

Subd. 5. **Jurisdiction.** The tax court shall have statewide jurisdiction. Except for an appeal to the supreme court or any other appeal allowed under this subdivision, the tax court shall be the sole, exclusive, and final authority for the hearing and determination of all questions of law and fact arising under the tax laws of the state, as defined in this subdivision, in those cases that have been appealed to the tax court and in any case that has been transferred by the district court to the tax court. . . . This subdivision shall not be construed to prevent an appeal, as provided by law, to an administrative agency, board of equalization, or to the commissioner of revenue. Wherever used in chapter 271, the term commissioner shall mean the commissioner of revenue, unless otherwise specified.

Minn. Stat. § 271.05 (1978).

271.05 POWER TO REVIEW. The tax court shall have power to review and redetermine orders or decisions of the commissioner of revenue upon appeal therefrom in the cases authorized by law.

Minn. Stat. § 271.06 (1978) (Orders of commissioner of revenue appealable to tax court).

271.06 APPEALS FROM ORDERS. Subdivision 1. **Manner.** Except as otherwise provided by law, an appeal to the tax court may be taken, in the manner herein provided, from any official order of the commissioner of revenue respecting any tax, fee, or assessment, or any matter pertaining thereto, or any matter concerning the tax laws listed in section 271.01, subdivision 5, by any person directly interested therein or affected thereby, or by any political subdivision of the state, directly or indirectly, interested therein or affected thereby, or by the attorney general in behalf of the state, or by any resident taxpayer of the state in behalf of the state in case the attorney general, upon request, shall refuse to appeal. . . .

* * *

Subd. 6. **Hearings; determination of issues; default.** The tax court shall hear, consider, and determine without a jury every appeal de novo. A tax court judge may empanel an advisory jury upon his motion. The tax court shall hold a public hearing in every case. All such parties shall have an opportunity to offer evidence and arguments at the hearing; provided, that the order of the commissioner or the appropriate unit of government in every case shall be prima

facie valid. When an appeal to the tax court has been taken from an order or determination of the commissioner or from the appropriate unit of government, the proceeding shall be an original proceeding in the nature of a suit to set aside or modify the order or determination. In case no appellant shall appear the tax court shall enter its order affirming the order of the commissioner of revenue or the appropriate unit of government from which the appeal was taken.

Minn. Stat. § 271.09 (1978) (Prepayment of disputed tax not required).

> Subd. 3. **Tax due obligation.** At the time of the taking of an appeal to the tax court, the taxpayer shall pay at least the amount of the tax or other obligation conceded by the taxpayer to be due, if any, when it becomes due provided that this shall not relieve the taxpayer from complying with any other requirements of law. . . .

Minn. Stat. § 271.10 (1978) (Tax court decisions appealable to Minnesota Supreme Court).

> **271.10 REVIEW BY SUPREME COURT.** Subdivision 1. **Certiorari.** A review of any final order of the tax court may be had upon certiorari by the supreme court upon petition of any party to the proceedings before the tax court. Such review may be had on the ground that the tax court was without jurisdiction, that the order of the tax court was not justified by the evidence or was not in conformity with law, or that the tax court committed any other error of law.

Minn. Rules pt. 8052.0100 (Repealed 1990) (previously codified as Minnesota Code of Agency Rules § 2052(2)) (Appeal of assessments to commissioner).

8052.0100 AUDIT AND REVIEW.

* * *

In a case where a taxpayer does not acquiesce in the proposed assessment, he may file a protest within the 30-day period specified in the letter accompanying the proposed assessment report. With respect to the proper form to be used in filing such protest, see part 8052.0200. If after a review of the taxpayer's protest, the division is unable to acquiesce therein, the taxpayer will be afforded an opportunity to have a hearing before a representative of the division upon request. If the taxpayer and the division are in agreement after such hearing, either the proposed assessment will be canceled or an order of the commissioner will issue in accordance with the terms of the agreement. In case the taxpayer does not acquiesce in the position taken by the division, he may request a hearing with respect to the same issues before the commissioner of revenue. If the taxpayer does not desire such a hearing, an order will be issued immediately. If a hearing before the commissioner is requested and granted, an order will not be issued until such time as the commissioner has made a final determination.

With the exception of the provisions of Minnesota Statutes, sections 271.06, subdivision 5 and 271.12, the issuance of an order by the commissioner of revenue constitutes a final determination. The taxpayer is granted a period of 30 days from the date of the mailing of such order

within which to file an appeal with the Tax Court of Appeals.

* * *

Minn. Rules pt. 8052.0200 (Repealed 1990) (previously codified as Minnesota Code of Agency Rules § 2052(3)) (Protest of assessment).

8052.0200 FORM OF PROTEST.

The protest, of which there must be two copies, should be executed under oath, and should contain the following information:

A. the name and address of the taxpayer;

B. in the case of a corporation, the state of incorporation and the principal office or place of business;

C. the designation by date and symbol of the letter informing the taxpayer of the changes with respect to which the protest is made;

D. designation of the years involved and a statement of the amount of tax in dispute for each year;

E. an itemized schedule of the findings to which the taxpayer takes exception;

F. a summary statement of the grounds upon which the taxpayer relies in connection with each exception;

G. in case the taxpayer desires a hearing, a statement to that effect; and

H. in case the protest is prepared or filed by an attorney or agent, a statement written on the document itself as an endorsement and signed by the attorney or agent, showing whether or not he prepared it and whether or not he knows of his own knowledge that the facts therein are true.

Minn. Stat. § 290.50 (1982 & Supp. 1983) (Refund procedures).

290.50 OVERPAYMENTS, CLAIMS FOR REFUND OR CREDITS.

Subdivision 1. **Procedure, time limit.** (a) A taxpayer who has paid or from whom there has been collected an amount of tax for any year in excess of the amount legally due for that year, may file with the commissioner a claim for a refund of such excess. Except as otherwise provided in this section, no claim or refund shall be allowed or made after three and one-half years from the date prescribed for filing the return (plus any extension of time granted for filing the return, but only if filed within the extended time) or after two years from the date of overpayment, whichever period is longer, unless before the expiration of the period a claim is filed by the taxpayer. For this purpose an income tax return or amended return claiming an overpayment shall constitute a claim for refund.

* * *

Subd. 2. **Denial of claim, court proceedings.** If the claim is denied in whole or in part, the commissioner shall mail an order of denial to the taxpayer in the manner prescribed in section 290.46. An appeal from this order may be taken to the Minnesota tax court in the manner prescribed in section 271.06, or the taxpayer may commence an action against the commissioner to recover the denied overpayment. Such action may be brought in the district court of the district in which lies the county of his residence or principal place of the business or if an

estate or trust, of the principal place of its administration, or in the district court for Ramsey county. The action in the district court shall be commenced within 18 months following the mailing of the order of denial to the taxpayer. If a claim for refund is filed by a taxpayer and no order of denial is issued within six months of the filing, the taxpayer may commence an action in the district court as in the case of a denial, but the action shall be commenced within two years of the date that the claim for refund was filed.

(2)

Supreme Court, U.S.
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No. 94-331

In The
Supreme Court of the United States
October Term, 1994

Minnesota Commissioner of Revenue
and the State of Minnesota,
Petitioners,

v.

Norwest Bank Duluth, N.A.,
Respondent.

Minnesota Commissioner of Revenue,
Petitioner,

v.

Cambridge State Bank, et al.,
Respondents.

On Petition For Writ of Certiorari
To the Minnesota Supreme Court

Brief in Opposition

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QUESTIONS PRESENTED

1. Whether the Minnesota Supreme Court was correct in holding that Respondents did not have a clear and certain predeprivation remedy under Minnesota law to challenge an unconstitutional tax.

2. Whether the Due Process Clause precludes a state court from ordering refunds of a voluntarily paid tax where a state refund statute has been construed as permitting taxpayers to obtain refunds of voluntarily paid taxes.

3. Whether estoppel under the so-called acceptance of benefits doctrine is a procedural bar within the meaning of *Harper v. Virginia Dep't of Taxation*, 113 S. Ct. 2510 (1993), and, if so, whether the Minnesota Supreme Court erred in refusing to apply it.

LIST OF PARTIES AND RULE 29.1 STATEMENT

The parties to the proceedings in the Minnesota Supreme Court were: (1) Respondents Norwest Bank Duluth, N.A. ("Norwest"), Cambridge State Bank ("Cambridge"), First Security State Bank of Sleepy Eye ("First Security") and Midway National Bank of St. Paul ("Midway"), and (2) Petitioners the Commissioner of the Minnesota Department of Revenue and the State of Minnesota. The current Minnesota Commissioner of Revenue is Morris J. Anderson.

The following is a Rule 29.1 listing of parent companies of the Respondents and subsidiaries of the Respondents other than wholly-owned subsidiaries.

Norwest Bank Duluth, N.A.
Norwest Corporation

Cambridge State Bank
None

First Security State Bank of Sleepy Eye
First Sleepy Eye Bancorp

Midway National Bank of St. Paul
None

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In The
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Minnesota Commissioner of Revenue
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On Petition For Writ of Certiorari
To the Minnesota Supreme Court

Brief in Opposition

Respondents respectfully request that this Court deny the Petition for Writ of Certiorari (hereinafter, "Pet.") seeking review of the decision of the Minnesota Supreme Court in this case. The opinion of the Minnesota Supreme Court is reported at 514 N.W.2d 565 and is reprinted in the appendix to the petition at App. 1.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Petitioners' summary of Minnesota statutes states that "orders of the Commissioner of Revenue assessing taxes were appealable to the Minnesota Tax Court," and that "prepayment of taxes in dispute was not required in order to appeal a tax assessment." Pet. 3. However, as discussed elsewhere in the petition, the Tax Court's power to review and redetermine orders of the Commissioner of Revenue (the "Commissioner") under Minn. Stat. § 271.05 (1980) was construed by the Minnesota Supreme Court not to extend to orders rejecting constitutional challenges to a tax. *In re McCannel*, 301 N.W.2d 910 (Minn. 1980).

Certain other Minnesota procedural statutes are relevant to this case and are reprinted in the appendix hereto (hereinafter, "Resp. App."). These include: the tax assessment provisions, Minn. Stat. §§ 290.46 and 290.49, Subd. 1 (1980)[1] (Resp. App. 1A-3A); the tax lien statute, Minn. Stat. § 290.54 (1980) (Resp. App. 5A-6A); the tax levy statute, Minn. Stat. § 290.48, Subd. 2 (1980) (Resp. App. 2A-3A); the negligence penalty statute, Minn. Stat. § 290.53, Subd. 3a (1980) (Resp. App. 5A); and the interest statutes, Minn. Stat. § 270.75, Subd. 1 (1980) (Resp. App. 1A) and Minn. Stat. § 290.50, Subd. 1(e) (1980) (Resp. App. 3A-4A).

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[1] Reference is made to the 1980 version of Minnesota Statutes because the tax returns for the 1979 year at issue were due in 1980. Petitioners have cited to the 1978 version of Minnesota Statutes. However, there are no material differences between the 1978 and 1980 statutes at issue in this case.

Minnesota law set forth procedures for claiming refunds and also "appropriated from the general fund to the Commissioner of Revenue the amounts necessary to make payments of refunds." Minn. Stat. § 290.50 (1980). Resp. App. 3A-5A. Another statute provided, "notwithstanding any other provision of the law," for the payment from the State general fund of "refunds of taxes erroneously collected from taxpayers." Minn. Stat. § 290.62 (1980). Resp. App. 6A.

STATEMENT OF THE CASE

During 1979, Minnesota imposed an excise tax on banks measured by net income. Minn. Stat. § 290.361 (1978). Pet. App. 96. Interest on federal obligations was taxable while interest on certain state obligations was exempt. Respondents paid the tax on federal obligation interest for 1979 and thereafter timely filed claims for refund following the procedures set forth in Minn. Stat. § 290.50 ("Section 290.50"). Resp. App. 3A-5A. Respondents asserted as a basis for their claims that the Minnesota bank excise tax was discriminatory in violation of 31 U.S.C. § 742 (1959) ("Section 742") and the intergovernmental immunity doctrine. In support of their claims, they cited *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), which held a nearly identical Tennessee tax to be discriminatory and unconstitutional. After the expiration of a statutory six-month waiting period during which the Commissioner failed to act upon their claims, Respondents timely filed refund actions in Ramsey County District Court against the Commissioner and the State of Minnesota, again following the procedures set forth in Section 290.50.[2]

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[2] Respondent Norwest filed suit for the 1979 year only. Respondents Cambridge, First Security and Midway, together with approximately 200 other banks, filed suit for the years 1979 through 1983 in a separate action, which was consolidated with the Norwest suit by the district court. By agreement of counsel and order of the district court, Respondents Cambridge, First Security and Midway were selected as "test banks" from among the numerous plaintiffs in the case, and 1979 was selected as the "test year." Judgment was entered as to the

The trial court held that the bank excise tax discriminated against federal obligations (Pet. App. 59) and awarded refunds under Section 290.50. Pet. App. 85. In its initial decision dated July 20, 1990 ("*Cambridge I*"), the Minnesota Supreme Court reversed. The court agreed that the tax was discriminatory (Pet. App. 43), but nonetheless held that the bank excise tax should be treated as lawful for 1979 on the theory that the 1983 *Memphis Bank* decision announced a new rule of law that should be applied on a prospective-only basis. Pet. App. 53. The court also held that Respondents were estopped from claiming refunds[3] and that it could award Respondents purely prospective relief.[4] Pet. App. 45-50.

Respondents filed a petition for a writ of certiorari with the United States Supreme Court requesting review of the Minnesota Supreme Court's decision. While the petition was pending, the Court decided *James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529 (1991). Because of the impact of *Beam* upon the issues addressed by Respondents' petition for writ of certiorari, the Court granted the petition, vacated the judgment of the Minnesota Supreme Court, and remanded the case for further consideration in light of *Beam*.

On remand, the Minnesota Supreme Court in a decision dated February 14, 1992 ("*Cambridge II*") reversed its original holding that *Memphis Bank* applied prospectively only. Pet. App. 25. However, the court adhered to its prior decision on estoppel

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test banks for the 1979 test year in accordance with Minnesota Rules of Civil Procedure 54.02, which permits final judgment with respect to fewer than all of the claims or parties when there is no just reason for delay.

[3] The court held that Respondents were estopped from challenging discrimination against federal obligations because Respondents also owned state obligations. (Pet. App. 25-30.)

[4] The court purported to award prospective relief by severing exemptions for state bonds on a prospective basis, an action having no practical effect since the Minnesota Legislature had previously repealed the exemptions following *Memphis Bank*, 1983 Minn. Laws Ch. 213.

and it again awarded "purely prospective relief." Pet. App. 33-36. The court distinguished *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990), in which a similar "purely prospective" remedy was held unconstitutional, because *McKesson* was a Commerce Clause case involving "comparative economic disadvantage" to other taxpayers caused by the discriminatory tax, whereas the damage in the instant case was to the Federal Government itself. Pet. App. 33. The court also distinguished *McKesson* because the taxpayer there had no clear prepayment remedy, whereas the court believed that Respondents had the option under state law to challenge the tax in the Minnesota Tax Court prior to paying it. Pet. App. 33.

Respondents again filed a petition for a writ of certiorari with the United States Supreme Court. While this second petition was pending, the Court decided *Harper v. Virginia Dep't of Taxation*, 113 S. Ct. 2510 (1993). The Court granted the petition, vacated the judgment, and again remanded the case to the Minnesota Supreme Court, this time for further consideration in light of *Harper*.

On remand, in a decision dated April 1, 1994 ("*Cambridge III*"), the Minnesota Supreme Court held: "After *Harper*, we can no longer distinguish *McKesson* on the ground that it applies only to commerce clause cases." Pet. App. 9. The court then analyzed Minnesota tax procedures and found (i) that there was no clearly available procedure for challenging taxes on a prepayment basis in 1980,[5] and (ii) that there was a clearly available refund procedure that Respondents followed. Pet. App. 12-13. The court held that

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[5] In making this finding, the court reversed its decision in *Cambridge II*. One explanation for this reversal is that Petitioners' claim that Respondents should have litigated in the Tax Court rather than the district court was first presented by Petitioners in their *reply* brief to the Minnesota Supreme Court in *Cambridge II*, at which point Respondents were allowed no additional briefing. By contrast, the issue was fully briefed by both sides in *Cambridge III*. Petitioners did not claim that Respondents were litigating in the wrong court during trial of the case. Nor did they make this argument in *Cambridge I*.

refunds should be awarded to Respondents and rested its decision on two alternative theories.

First, citing *McKesson*, the court held that because of the absence of a prepayment procedure, the court was required to design a remedy "which creates in hindsight a nondiscriminatory scheme." Pet. App. 15. The court considered and rejected a remedy that would have imposed a retroactive tax on exempt state obligations,[6] and concluded that the appropriate remedy was to award refunds payable over a four-year period in order to mitigate the financial burden upon the State.

As an alternative ground, the court held that Respondents' reliance on the Minnesota refund statute entitled them to refunds. The court noted that Minnesota taxpayers in 1980 had not been put on notice that they should bring constitutional challenges in the Minnesota Tax Court. Accordingly, the court concluded that "*even if there was a predeprivation remedy in 1980*," Respondents were entitled to refunds. Pet. App. 14 (emphasis added). The court cited *Brinkerhoff-Faris Trust & Sav. Co. v. Hill*, 281 U.S. 673 (1930) in support of this conclusion. Pet. App. 15.

REASONS FOR DENYING THE WRIT

Petitioners request certiorari to reverse the decision of the Minnesota Supreme Court awarding refunds to Respondents. They cite *McKesson* and *Harper* in support of their position. However, *McKesson* and *Harper* addressed only the *minimum* due process that a state must provide. The Court in both cases made clear that a state "may provide relief beyond the demands of federal due process." *Harper*, 113 S. Ct. at 2520; *see also McKesson*, 496 U.S. at 52 n.36. A state is "free to choose which form of relief it will provide, so long as that relief satisfies the minimum federal [due process] requirements." *McKesson*, 496 U.S. at 51-52.

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[6] In so deciding, the court took note of the practical difficulty that the Commissioner would have in actually collecting a retroactive tax applicable to the 1979 tax year, as well as of the questionable constitutionality of imposing such a tax on income earned fifteen years ago. Pet. App. 16.

Petitioners ask this Court to reverse the Minnesota Supreme Court because, in their view, the court gave Respondents more than due process requires. However, even if this were true, the extent to which a state chooses to provide more than minimal due process involves an issue of state law that does not implicate the Federal Constitution. Accordingly, the petition for certiorari does not raise a substantial federal question. For this reason, and for the reasons set forth below, the petition should be denied.

I. CERTIORARI SHOULD BE DENIED BECAUSE THE MINNESOTA SUPREME COURT RESTED ITS DECISION UPON AN ALTERNATIVE GROUND THAT WAS AN INDEPENDENT AND ADEQUATE STATE LAW GROUND, AND THAT WAS NOT CHALLENGED IN THE PETITION.

Petitioners have presented three questions in their petition. Each of the three asks whether different aspects of the Minnesota Supreme Court's decision following *Harper*, and by extension *McKesson*, were correct. However, the Minnesota Supreme Court did not rest its decision entirely on *Harper* and *McKesson*. The court held, in the alternative, that Respondents' use of and reliance upon the Minnesota statutory refund procedures gave them a right to a refund. The court stated:

> The existence of the tax refund statute in Minnesota provides further support for our decision. To rely on the bank's use of the refund statute to now deny them a remedy would effectively deny the banks a meaningful hearing without adequate notice. Prior to the *McKesson* decision, taxpayers had no notice that they were required to take advantage of any predeprivation procedures in order to qualify for a refund. Even if there was a predeprivation remedy in 1980, the banks did not know when they chose between filing for a refund in district court and filing in tax

court, that in choosing a refund action, they were foreclosing their right to recovery.* Moreover, the tax refund statute did not have a requirement that the tax be paid under protest or that the taxpayer attempt to first take his or her claim to tax court. *See Brinkerhoff-Faris Trust and Sav. Co. v. Hill*, 281 U.S. 673 (1930) (finding due process violation when Missouri Supreme Court denied remedy to taxpayer by holding that taxpayer failed to take advantage of administrative remedies when court had previously found agency lacked power to hear the type of case at issue).

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* This issue did not arise in *McKesson* itself because the Court there found that taxpayers did not have a meaningful predeprivation remedy, thus a remedy was due regardless of whether it was required under Florida's tax refund statute.

Pet. App. 14-15. This holding is unquestionably correct and has not been challenged by Petitioners.

In *Harper* and *McKesson*, this Court held that a state must, at a minimum, provide meaningful postdeprivation relief (which may consist of refunds) if the state does not provide a clear and certain predeprivation remedy. The Court also held that a state is "free, of course, to provide broader relief as a matter of state law than is required by the federal Constitution." *McKesson*, 496 U.S. at 52 n.36. Minnesota went beyond the due process minimum when it adopted Section 290.50, the state income tax refund statute.

At common law, taxpayers were precluded from recovering voluntarily paid taxes. *Horn v. City of Minneapolis*, 234 N.W. 289 (Minn. 1930). Many jurisdictions, including the Federal Government, have liberalized the common law rule by adopting

refund statutes allowing the recovery of such taxes.[7] Minnesota statutes have long provided for the recovery of voluntarily paid taxes. In the instant case, the Minnesota Supreme Court expressly stated that Section 290.50 "did not have a requirement that the tax be paid under protest . . ." Pet. App. 15. *See also Acton Constr. Co. v. Commissioner of Revenue*, 391 N.W.2d 828, 832 (Minn. 1986) (discussing sales tax statute substantially similar to Section 290.50).

The Minnesota Supreme Court has consistently construed Minnesota's refund statutes as requiring the Commissioner to refund unconstitutional taxes. For example, on remand from this Court's decision in *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 460 U.S. 575 (1983), the Minnesota Supreme Court affirmed the judgment of the trial court awarding refunds of an unconstitutional sales and use tax. *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 332 N.W.2d 914 (Minn. 1983). In another recent case, the Minnesota Supreme Court affirmed the trial court's award of refunds where the individual income tax in question violated Section 742, the same federal statute involved in this case. *Yurista v. Commissioner of Revenue*, 460 N.W.2d 24 (Minn. 1990). The taxpayer's refund action was brought under Section 290.50.

In awarding refunds to Respondents, the Minnesota Supreme Court was simply following Section 290.50 and its prior decisions. Accordingly, this alternative basis for the court's decision is properly viewed as an independent and adequate state law ground. The United States Supreme Court is without jurisdiction to review a decision based upon an independent and adequate state law ground. *Fox Film Corp. v. Muller*, 296 U.S. 207, 210 (1935). The petition must therefore be denied.

Even if the basis for the court's holding were not strictly a state law ground, but also involved due process principles, the

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[7] *See George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 379 (1933) (by adopting the federal refund statute, "[a] high-minded Government renounced an advantage that was felt to be ignoble, and set up a new standard of equity and conscience.")

petition should nonetheless be denied because Petitioner has not objected to this holding of the Minnesota Supreme Court. *See Irvine v. California*, 347 U.S. 128, 129 (1954) (certiorari limited to questions identified in the petition). Furthermore, the court's holding was clearly correct.

As the Minnesota Supreme Court noted, even if the Minnesota Tax Court was available to resolve constitutional challenges in 1980, Section 290.50 was also available as an alternative procedure. In fact, in a 1979 case upholding the creation of the Minnesota Tax Court against constitutional challenge, the Minnesota Supreme Court observed that "it is crucial to note that the taxpayer always has the option to file in district court" by paying the tax and claiming a refund under Section 290.50, and that "[t]his is perhaps the saving feature of this statutory scheme." *Wulff v. Tax Court of Appeals*, 288 N.W.2d 221, 225 (Minn. 1979).

Respondents relied upon and strictly followed the refund procedures of Section 290.50. Petitioners did not object to the use of Section 290.50 or to Respondents' compliance therewith during the trial phase of this case. It was only in *Cambridge II*, following the remand of the case by this Court in light of *Beam*, that Petitioners for the first time claimed that refunds could be denied because Respondents could have challenged the tax in the Minnesota Tax Court prior to paying it. By that time, of course, the alternative route was no longer open to Respondents because they had already paid the tax and claimed a refund. Under these circumstances, the Minnesota Supreme Court correctly held that to deny Respondents the use of the refund statute would be to "effectively deny the banks a meaningful hearing without adequate notice." Pet. App. 14.[8]

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[8] *Brinkerhoff-Faris Trust & Sav. Co. v. Hill*, 281 U.S. 673 (1930), which was cited by the Minnesota Supreme Court, is closely analogous. The state court there had previously held that the state tax authorities did not have jurisdiction over constitutional tax challenges and also held that such challenges could be brought as injunction actions. Following this procedure, the taxpayer bypassed the tax commissioner in a constitutional challenge to a tax. On appeal to the state

It should be noted that the issue of whether a taxpayer's reliance upon a state refund statute creates an interest protected by due process is not presented in *Reich v. Collins*, 437 S.E.2d 320 (Ga. 1993), *cert. granted in part*, 114 S. Ct. 1048 (1994).[9] Thus, there is no reason to defer decision on the Petitioners' petition pending decision in *Reich*, as requested by Petitioners. Pet. App. 11. The petition should be denied.

II. CERTIORARI SHOULD BE DENIED BECAUSE, AS FOUND BY THE MINNESOTA SUPREME COURT, RESPONDENTS DID NOT HAVE A CLEAR AND CERTAIN REMEDY AVAILABLE TO THEM IN THE MINNESOTA TAX COURT.

Under *McKesson*, if a state does not offer a "meaningful opportunity for taxpayers to withhold contested tax assessments and to challenge their validity in a predeprivation hearing," then the state must provide postdeprivation relief. 496 U.S. 18, 38 n.21. A "meaningful opportunity" exists only if there is a "fair opportunity to challenge the accuracy and legal validity of" a tax as well as "a 'clear and certain remedy' for any erroneous or unlawful tax collection . . ." 496 U.S. 18 (citation omitted).

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supreme court, the court reversed its prior decision and held that the taxpayer should have exhausted its administrative remedies. Since the period of limitations for doing so had passed, the court dismissed the taxpayer's suit. The United States Supreme Court reversed because the state court had "denied to the plaintiff due process of law -- using that term in its primary sense of an opportunity to be heard and to defend its substantive right." *Id.* at 678.

[9] Certiorari was granted only on the question of whether the State of Georgia provided a clear and certain remedy to the taxpayers in *Reich*. The Court denied certiorari on the issue of whether the taxpayer in *Reich* had a due process interest in the Georgia refund statute, presumably because the Georgia Supreme Court as a matter of state law held that the refund statute was inapplicable. By contrast, the Minnesota Supreme Court has held that the Minnesota refund statute applies to this case.

The Minnesota Supreme Court concluded that the remedies available by petition to the Minnesota Tax Court were not "clear and certain" in 1980 because the Tax Court did not have jurisdiction over constitutional challenges to state taxes, and because there was no established procedure in place in 1980 by which the Tax Court could have acquired such jurisdiction. While the adequacy of a predeprivation remedy is a federal question, clearly the state courts are in the best position to understand the intricacies of state tax procedure. If a state supreme court determines that its prepayment procedures were not "clear and certain" in the constitutional sense, then this Court as a general rule ought to defer to that determination.

In the instant case, there is absolutely no question but that the Minnesota Supreme Court was correct in holding that Respondents in 1980 did not have a "clear and certain" remedy in the Minnesota Tax Court. The present full-time Minnesota Tax Court was created in 1977. 1977 Minn. Laws Ch. 307. Previously there had been various administrative bodies authorized to hear tax disputes. *See* Gustafson, *Minnesota Tax Appeals* § 1.01 (1992). From the beginning, there was considerable doubt regarding the authority of the Tax Court to hear constitutional claims because the court was an administrative agency of the executive branch of state government rather than a true court.

In a 1977 case, *Harris v. Commissioner of Revenue*, 257 N.W.2d 568 (Minn. 1977), the Minnesota Supreme Court questioned the jurisdiction of the Tax Court to decide constitutional issues without the jurisdictional issue having even been raised by the parties to the case. 257 N.W.2d at 569 n.1. After *Harris*, taxing authorities -- including the Department of Revenue -- began to assert that taxpayers could not bring constitutional claims in the Tax Court. The issue was decided in two 1980 cases, *In re McCannel*, 301 N.W.2d 910 (Minn. 1980) and *Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138 (Minn. 1980). In these cases the Minnesota Supreme Court held that the Tax Court did not have constitutional jurisdiction. Further, the Minnesota

Supreme Court in these cases did not establish any procedure by which the Tax Court could obtain constitutional jurisdiction.[10]

After *McCannel* and *Guilliams* were decided, the Tax Court dismissed for lack of subject matter jurisdiction claims that challenged the constitutionality of a statute *per se*. *See DeCoster v. Commissioner of Revenue*, No. 3207-S, 1981 W.L. 1456 (Minn. Tax Ct. Jan. 29, 1981). In its opinion below, the Minnesota Supreme Court concluded that, had Respondents brought their case in the Tax Court, the case would either have been dismissed or -- at best -- transferred to a state district court where payment of the tax might have been required.[11] Pet. App. 13-14. The Court compared this highly dubious procedure with the alternative refund procedure under Section 290.50, and observed: "In light of the uncertainty regarding the reach of the tax court's jurisdiction and the clear availability of the statutory refund procedure, we cannot assert that the meaningful predeprivation remedy required by *McKesson* existed in early to mid-1980," and that the existence of such a remedy was "even more questionable" after that. Pet. App. 12-13.[12] This conclusion was clearly correct.[13]

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[10] *McCannel* and *Guilliams* were foreshadowed by *Dependents of Ondler v. Peace Officers Benefit Fund*, 289 N.W.2d 486 (Minn. 1980), decided in January 1980, in which it was held that the Workers' Compensation Court of Appeals, which was an administrative agency of the executive branch of state government like the Tax Court, did not have jurisdiction to decide constitutional issues.

[11] State district courts have never had jurisdiction to hear appeals from orders of the Commissioner on a prepayment basis.

[12] In 1984, the Minnesota Supreme Court approved a procedure under which the Tax Court could obtain jurisdiction over constitutional questions in a case if it transferred the case to a district court and if the district court transferred the case back to the Tax Court. *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261 (Minn. 1984). In its opinion below, the Minnesota Supreme Court correctly observed that this procedure was available in 1980 only through hindsight. In their petition, Petitioners dispute this observation, noting that another taxpayer successfully used the so-called "*Erie* shuffle" prior to the *Erie* decision. *See Nagaraja v. Commissioner of Revenue*, 352 N.W.2d 373 (Minn.

Further, the issue raised by the Petitioners is not of such importance as to warrant review by this Court. The issue is of historical interest only, since Minnesota's tax procedures have changed in a number of respects following the year at issue.

Finally, as noted above, even if a predeprivation procedure was available in 1980, the Minnesota Supreme Court was free to go beyond the minimum due process requirements by awarding refunds. Accordingly, the petition should be denied.

III. CERTIORARI SHOULD BE DENIED BECAUSE STATE LAW AND THE FEDERAL CONSTITUTION ALLOW THE MINNESOTA SUPREME COURT TO ORDER REFUNDS OF VOLUNTARILY PAID TAXES.

Petitioners argue that the Court should grant certiorari to decide whether states are "required" to provide refunds of

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1984). Pet. App. 15-16 n.9. This is disingenuous for, as the Minnesota Supreme Court observed, *Nagaraja* was a refund case, not a prepayment case. Further, the procedure was so *unclear* that the Commissioner argued in *Nagaraja* that the Tax Court lacked jurisdiction notwithstanding the district court transfer. Pet. App. 13 n.10.

[13] Petitioners also claim that a prepayment remedy existed in the form of a declaratory judgment action. Pet. 21 n.13. They did not present this claim to the Minnesota Supreme Court. In any event, a declaratory judgment action could not have been brought in light of *Land O' Lakes Dairy Co. v. Village of Sebeka*, 31 N.W.2d 660 (Minn.), *cert. denied*, 334 U.S. 844 (1948), in which it was held that an action for declaratory judgment could not be brought if a statutory remedy for challenging a tax existed. *See also M.A. Mortenson Co. v. Minnesota Comm'r of Revenue*, 470 N.W.2d 126 (Minn. Ct. App. 1991) (following *Land O' Lakes Dairy*). Petitioners' claim that Respondents had a prepayment remedy in the form of an administrative protest also was not presented to the Minnesota Supreme Court, and is also erroneous. As a member of the executive branch of state government, the Commissioner would have had no more power to declare a statute unconstitutional than the Tax Court would have had. *Cf. Dependents of Ondler*, 289 N.W.2d at 487 n.1 (administrative agencies do not have jurisdiction to adjudicate the constitutionality of legislation).

unconstitutional taxes if the taxes were voluntarily paid. This issue is simply not presented by the Minnesota Supreme Court's decision in *Cambridge III*.

As noted above, the decision rested upon two grounds. Insofar as the court held that it should award refunds under Section 290.50, the issue does not arise because Section 290.50 allows taxpayers to recover taxes that were voluntarily paid. The court observed that "the tax refund statute did not have a requirement that the tax be paid under protest . . ." Pet. App. 15. The Minnesota Supreme Court awarded refunds not because it believed that federal law required it to do so, but rather because the court was following Minnesota law. The holding is therefore one of state law and does not raise an issue reviewable by this Court.

Insofar as the court's decision rested upon its conclusion that *McKesson* required it to "design a clear and certain remedy which creates in hindsight a nondiscriminatory scheme," Pet. App. 15, the Minnesota Supreme Court was simply fulfilling its role within the federal system of determining what the remedy for an unconstitutional tax should be. *McKesson* holds that a "clear and certain remedy" is required, but that a state "may satisfy this obligation through any form of relief," including refunds. 496 U.S. at 51. A state is "free to choose which form of relief it will provide, so long as that relief satisfies the minimum federal [due process] requirements." 496 U.S. at 51-52; *cf. Harper*, 113 S. Ct. at 2520 (". . . we leave to Virginia courts . . . the crafting of any appropriate remedy.")

The Minnesota Supreme Court considered and rejected the possibility that a retroactive tax on exempt state obligation income would cure the discrimination against federal obligations that existed in 1979. It also considered and rejected a partial retroactive tax coupled with partial refunds. Pet. App. 15-17. The court noted that refunds would place a burden on the state, but also noted that "the state has collected the unconstitutional tax for many years for which the banks will not recover due to the statute of limitations on tax refund actions." Pet. App. 16. After giving "consideration to equitable factors in fine-tuning this refund

remedy," the court ordered the payment of refunds over four years. Pet. App. 17.

This Court has left to the state courts the task of crafting appropriate remedies for unconstitutional taxation. A state "may provide relief beyond the demands of federal due process, but under no circumstances may it confine [a taxpayer] to a lesser remedy." *Harper*, 113 S. Ct. at 2520 (citations omitted). Even if the taxes at issue in this case were voluntarily paid,[14] and even if there had been no refund statute in Minnesota, the Minnesota Supreme Court would clearly have been entitled to go beyond the minimal demands of federal due process and award refunds.

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[14] The petition cites "credible explanations" for why Petitioners believe the tax payments were voluntary. Pet. 23-25. However, these "explanations" are based on sheer speculation and have no support in the record. Respondents do not agree that the taxes in question were voluntarily paid. When a tax is paid "in order to avoid financial sanctions or a seizure of real or personal property, the tax is paid under 'duress' in the sense that the State has not provided a fair and meaningful predeprivation procedure." *McKesson*, 496 U.S. at 38 n.21. Under Minnesota law in 1980, the year the taxes in question were due and payable, a taxpayer electing to challenge a tax would have been under duress to pay the tax. The Commissioner was empowered to assess a tax deficiency, Minn. Stat. §§ 290.46 and 290.49, Subd. 1 (1980), Resp. App. 1A-3A, and assessment had to occur before the taxpayer could file an appeal with the Tax Court. Following assessment, the Commissioner had the power to impose a lien upon all of the taxpayer's property, except a homestead, by filing a notice of lien. Minn. Stat. § 290.54. Resp. App. 5A-6A. If a tax was not paid "within 60 days after it [was] required to be paid," the Commissioner had the power to levy upon and sell the real and personal property of the taxpayer. Minn. Stat. § 290.48, Subd. 2 (1980). Resp. App. 2A-3A. Since taxes were required to be paid within 60 days following assessment, Minn. Stat. § 290.46 (1980), Resp. App. 1A-2A, the Commissioner had the power to levy during the pendency of a Tax Court proceeding. Further, a taxpayer withholding payment of tax might be assessed a negligence penalty equal to 5 percent of an assessment. Minn. Stat. § 290.53, Subd. 3a (1980). Resp. App. 5A. Moreover, interest on deficiencies accrued at eight percent in 1980, as compared with the refund interest rate of six percent. Minn. Stat. §§ 270.75, Subd. 1 and 290.50, Subd. 1(a). Resp. App. 1A and 4A. All of these provisions created duress to pay the tax, thus obligating Minnesota to provide postdeprivation relief in the form of refunds. Respondents presented this argument to the Minnesota Supreme Court, but the court did not reach the issue.

Accordingly, the question presented does not raise a substantial federal question and the petition should be denied.

IV. CERTIORARI SHOULD BE DENIED BECAUSE THE MINNESOTA SUPREME COURT'S DECISION ON ESTOPPEL RESTED UPON STATE LAW AND BECAUSE, IN ANY EVENT, ESTOPPEL IS NOT A PROCEDURAL BAR.

Petitioners have argued that Respondents should be estopped under the so-called acceptance of benefits doctrine from recovering refunds of taxes paid on federal obligation interest income because they owned state obligations. The acceptance of benefits doctrine applies only if a litigant receives a benefit from a statute that is claimed to be unconstitutional. *Kadrmas v. Dickinson Pub. Schools*, 487 U.S. 450, 456-457 (1988). For example, in *Fahey v. Mallonee*, 332 U.S. 245 (1947), a federal savings and loan was estopped from challenging conditions in a statute under which it was organized.

The trial court found as a fact that Respondents did not benefit from the provisions of Minnesota Statutes that they claimed were unconstitutional (i.e., the tax on federal obligation interest), and also held that the theory was no longer the law in Minnesota. Pet. App. 65-66. The Minnesota Supreme Court affirmed the trial court without explicitly discussing the estoppel issue. While the basis for the court's decision is unclear, its affirmance of the trial court indicates that it agreed with the trial court on the facts, on the law, or on both the facts and the law. None of these grounds presents a question reviewable by this court.

Nonetheless, Petitioners claim that estoppel is a procedural bar that can be raised as a defense to refund actions. The Court in *McKesson* observed that a state could "provide by statute that refunds will be available only to those taxpayers paying under protest or providing some other timely notice of complaint," and that it could also "enforce relatively short statutes of limitation." 496 U.S. at 45. Even if the estoppel theory had been accepted by the Minnesota Supreme Court, however, estoppel would not have

been a procedural bar; it would have been a substantive bar. *See Suske v. Straka*, 39 N.W.2d 745, 750 (Minn. 1949)(estoppel not a rule of evidence or procedure, but a rule of substantive law).[15] There is nothing in the least procedural about it. The procedural requirements (including a statute of limitations) for obtaining a tax refund in Minnesota were set forth in Section 290.50. Respondents strictly complied with the requirements of this statute.

Furthermore, it should again be noted that the Minnesota Supreme Court was free to choose what sort of relief it would provide, so long as it satisfied the minimum federal due process requirements. *McKesson*, 496 U.S. at 51-52. The court was under no obligation to apply the estoppel doctrine, even if it were applicable.[16] Accordingly, Petitioners' petition for certiorari should be denied.

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[15] Petitioners assert that estoppel is a procedural bar, citing *Cambridge I* and *II*. Pet. 25. However, the decisions in *Cambridge I* and *II* were left without force or effect following the remands in light of *Beam* and *Harper*. Pet. App. 5; Pet. App. 22. The holding in *Suske* that estoppel is substantive has thus not been overruled in Minnesota. In any event, merely labelling estoppel as a procedural bar when it manifestly is not cannot control for federal constitutional purposes.

[16] Respondents argued in the Minnesota Supreme Court that the doctrine was *not* applicable for the following reasons: that the doctrine was no longer the law in Minnesota; that the doctrine was inapplicable on the facts; that the doctrine was inapplicable because Respondents did not receive a benefit; and that application of the doctrine would discriminate against persons bringing claims under Section 742.

CONCLUSION

For the foregoing reasons, the petition should be denied.

Respectfully submitted,

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APPENDIX

Minn. Stat. § 270.75 (1980) INTEREST PAYABLE TO COMMISSIONER.

Subdivision 1. If any tax payable to the commissioner of revenue or to the department of revenue is not paid within the time specified by law for payment, the unpaid tax shall bear interest at the rate of eight percent per annum from the date such tax should have been paid until the date that the tax was paid, unless otherwise provided by law. Unpaid taxes collected under section 290.92 or under chapter 297A shall bear interest at the rate of ten percent per annum from the date such tax should have been paid until the date that the tax was paid.

Minn. Stat. § 290.46 (1980) EXAMINATION OF RETURNS; ASSESSMENTS, REFUNDS.

The commissioner shall, as soon as practicable after the return is filed, examine the same and make any investigation or examination of the taxpayer's records and accounts that he may deem necessary for determining the correctness of the return. The tax computed by him on the basis of such examination and investigation shall be the tax to be paid by such taxpayer. If the tax found due shall be greater than the amount reported as due on the taxpayers's return, the commissioner shall assess a tax in the amount of such excess and the whole amount of such excess shall be paid to the commissioner within 60 days after notice of the amount and demand for its payment shall have been mailed to the taxpayer by the commissioner. If the understatement of the tax on the return was false and fraudulent with intent to evade the tax, the installment of the tax shown by the taxpayer on his return which have not yet been paid shall be paid to the commissioner within 60 days after notice of the amount thereof and demand for payment shall have been mailed to the taxpayer by the commissioner. If the

amount of the tax found due by the commissioner shall be less than that reported as due on the taxpayer's return, the excess shall be refunded to the taxpayer in the manner provided by section 290.50 (except that no demand therefor shall be necessary), if he has already paid the whole of such tax, or credited against any unpaid installment thereof; provided, that no refundment shall be made except as provided in section 290.50, after the expiration of three and one-half years after the filing of the return . . . .

Minn. Stat. § 290.48 (1980) DELINQUENT TAXES, COLLECTION.

Subdivision 2. **Levy and sale.** If a tax imposed by this chapter, or any portion of such tax, is not paid within 60 days after it is required to be paid thereunder, the commissioner shall issue his warrant to the sheriff of any county of the state commanding him to levy upon and sell the real and personal property of the taxpayer and to levy upon the rights to property of the taxpayer within the county, and to return such warrant to the commissioner and pay to him the money collected by virtue thereof by a time to be therein specified, not less than 60 days from the date of the warrant. The sheriff shall proceed thereunder to levy upon and seize any property of the taxpayer and to levy upon the rights to property of the taxpayer within his county, except the homestead and household goods of the taxpayer and property of the taxpayer not liable to attachment, garnishment, or sale on any final process issued from any court under the provisions of section 550.37, and shall sell so much thereof as is required to satisfy such taxes, interest, and penalties, together with his costs; but such sales shall, as to their manner, be governed by the laws applicable to sales of like property on execution issued against property upon a judgment of a court of record. The proceeds of such sales, less the sheriff's costs, shall be turned over to the commissioner, who shall retain such part thereof as is required to satisfy the tax, interest, penalties, and costs, and pay over any balance to the taxpayer. The commissioner shall not proceed under this subdivision until the

expiration of 60 days after mailing to the taxpayer, at his last known address, a written notice of the amount of taxes, interest, and penalties due from the taxpayer and demand for their payment. Any action taken by the commissioner pursuant to this subdivision shall not constitute an election by the state to pursue a remedy to the exclusion of any other remedy provided for in this act.

Minn. Stat. § 290.49 (1980) TIME LIMIT ON ASSESSMENT, COLLECTION.

Subdivision 1. **Assessment, generally.** Except as otherwise provided in this chapter the amount of taxes assessable shall be assessed within three and one-half years after the return is filed. Such taxes shall be deemed to have been assessed within the meaning of this section whenever the commissioner shall have determined the taxable net income of the taxpayer and computed and recorded the amount of tax with respect thereto, and if the amount is found to be in excess of that originally declared on the return, whenever the commissioner shall have prepared a notice of tax assessment and mailed the same to the taxpayer. The notice of tax assessment shall be sent by mail to the post office address given in the return, and the record of such mailing shall be presumptive evidence of the giving of such notice, and such records shall be preserved by the commissioner.

Minn. Stat. § 290.50 (1980) OVERPAYMENT, CLAIMS FOR REFUND OR CREDITS.

Subdivision 1. **Procedure, time limit.** (a) A taxpayer who has paid or from whom there has been collected an amount of tax for any year in excess of the amount legally due for that year, may file with the commissioner a claim for a refund of such excess. Except as otherwise provided in this section, no claim or refund shall be allowed or made after three and one-half years from the date prescribed for filing the return (plus any extension of time granted

for filing the return, but only if filed within the extended time) or after two years from the date of overpayment, whichever period is longer, unless before the expiration of the period a claim is filed by the taxpayer. For this purpose an income tax return or amended return claiming an overpayment shall constitute a claim for refund.

* * * *

(e) Except as provided in section 290.92, subdivision 13, and 290.936, interest on the overpayment refunded or credited to the taxpayer shall be allowed at the rate of six percent per annum computed from the date of payment of the tax until the date the refund is paid or credit is made to the taxpayer. However, to the extent that the basis for the refund is a net operating loss carryback, a capital loss carryback or the carryback of a pollution control credit, interest shall be computed only from the end of the taxable year in which the loss occurs or in which the pollution control credit arises.

* * * *

(g) There is hereby appropriated from the general fund to the commissioner of revenue the amounts necessary to make payments of refunds allowed pursuant to this section.

* * * *

Subdivision 2. Denial of claim, court proceedings. If the claim is denied in whole or in part, the commissioner shall mail an order of denial to the taxpayer in the manner prescribed in section 290.46. An appeal from this order may be taken to the Minnesota tax court in the manner prescribed in section 271.06, or the taxpayer may commence an action against the commissioner to recover the denied overpayment. Such action may be brought in the district court of the district in which lies the county of his residence or principal place of business or if an estate or trust, of the principal place of its administration, or in the district court for

Ramsey county. The action in the district court shall be commenced within 18 months following the mailing of the order of denial to the taxpayer. If a claim for refund is filed by a taxpayer and no order of denial is issued within six months of the filing, the taxpayer may commence an action in the district court as in the case of a denial, but the action shall be commenced within two years of the date that the claim for refund was filed.

Minn. Stat. § 290.53 (1980) PENALTIES, INTEREST.

Subdivision 3a. **Intentional disregard of rules and regulations.** If any part of any additional assessment, as determined under section 290.46, is due to negligence or intentional disregard of rules and regulations (but without intent to defraud), there shall be added to the tax an amount equal to five percent of such additional assessment.

Minn. Stat. § 290.54 (1980) TAX A PERSONAL DEBT.

The tax imposed by this chapter, and interest and penalties imposed with respect thereto, shall become a personal debt of the taxpayer from the time the liability therefor arises, irrespective of when the time for discharging such liability by payment occurs. The debt shall, in the case of the personal representative of the estate of a decedent and in the case of any fiduciary, be that of such person in his official or fiduciary capacity only unless he shall have voluntarily distributed the assets held in such capacity without reserving sufficient assets to pay such tax, interest, and penalties, in which event he shall be personally liability for any deficiency. This provision shall apply only to cases in which this state is legally competent to impose such personal liability.

The tax imposed by this chapter, and interest and penalties imposed with respect thereto, shall become a lien upon all of the property, both real and personal, of the taxpayer within this state, except his homestead, from and after the filing by the

commissioner of a notice of such lien in the office of the county recorder of the county in which such property is situated, or in the case of personal property belonging to an individual who is not a resident of this state, or which is a corporation, partnership, or other organization, in the office of the secretary of state.

The lien created under this section shall become effective with respect to personal property from and after the date of filing by the commissioner of a notice of such lien describing the property to which the lien attaches in the office of the county recorder of the county in which the commissioner believes the property is located at the time such lien is filed, and with the secretary of state.

The lien imposed on personal property by this section, even though properly filed, shall not be valid as against a purchaser with respect to tangible personal property purchased at retail or as against the personal property listed as exempt in sections 550.37, 550.38, and 550.39.

Minn. Stat. § 290.62 (1980) DISTRIBUTION OF REVENUES.

All revenues derived from the taxes, interest, penalties and charges under this chapter shall, notwithstanding any other provisions of law, be paid into the state treasury and credited to the general fund, and be distributed as follows:

(1) There shall, notwithstanding any other provisions of law, be paid from this general fund all refunds of taxes erroneously collected from taxpayers under this chapter as provided herein;

(2) There is hereby appropriated to the persons entitled to payment herein, from the fund or account in the state treasury to which the money was credited, an amount sufficient to make the refund and payment.

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(3)

In The

Supreme Court of the United States

October Term, 1994

MINNESOTA COMMISSIONER OF REVENUE AND THE STATE OF MINNESOTA,

Petitioners,

v.

NORWEST BANK DULUTH, N.A.,

Respondents.

MINNESOTA COMMISSIONER OF REVENUE,

Petitioner,

v.

CAMBRIDGE STATE BANK, *et al.*,

Respondents.

On Petition For Writ Of Certiorari To The Minnesota Supreme Court

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Petitioners respectfully submit this Reply Brief in response to the Brief in Opposition filed by respondents.

I. THERE WAS NO INDEPENDENT AND ADEQUATE STATE LAW GROUND FOR THE DECISION OF THE MINNESOTA SUPREME COURT, WHICH ERRONEOUSLY CONCLUDED IT WAS COMPELLED BY *HARPER* TO REVERSE ITS PRIOR DECISIONS.

In their brief in opposition (hereinafter "Resp. Br."), respondent banks argue that the petition for writ of certiorari should be denied because the decision of the Minnesota Supreme Court rests on an independent and adequate state law ground. This is incorrect. In fact, only one justice of the Minnesota court would have based an award of refunds on the state law ground cited by respondents, a view that he expressed in a special concurrence. (Pet. App. 17). The majority opinion was based solely on the Minnesota court's erroneous reading of this Court's decisions in *Harper v. Virginia Dept. of Taxation*, 113 S. Ct. 2510 (1993) and *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18 (1980).

In its two previous decisions in this case (reproduced at Pet. App. 19 and Pet. App. 37), the Minnesota Supreme Court held that under Minnesota law, respondent banks were not entitled to refunds of corporate franchise taxes paid. After this Court's remand for reconsideration in light of *Harper*, the Minnesota court stated that, given *Harper's* clarification that *McKesson* directly controls this case, the court was required carefully to reconsider whether a predeprivation remedy which satisfies *McKesson's* requirements existed in Minnesota at the time the taxes were paid by respondent banks. (Pet. App. 11). In doing so, the court concluded that jurisdictional uncertainties called into question the adequacy of an administrative tax court proceeding as predeprivation remedy. The Minnesota court's decision thus centered on its apparent belief that due process is not satisfied if any

doubt can be raised regarding the scope of a prepayment procedure.

Having concluded on this basis that Minnesota did not provide a meaningful predeprivation remedy in 1980 (the year the taxes due for the 1979 test year would have been paid), the court stated that "*McKesson* commands that we design a clear and certain remedy which creates in hindsight a nondiscriminatory scheme." (Pet. App. 15). The court then stated that it had three options, again citing *McKesson*: a refund of taxes paid, a retroactive tax on exempted income, or a combination of the two. The court chose refunds, not because state law required refunds, but because of "possible difficulties inherent in collecting a retroactive tax" and concerns with regard to the constitutionality of such a tax. (Pet. App. 16).

Thus, contrary to respondents' first argument for denial of certiorari, the Minnesota court did not hold that refunds are required under state law, nor did it base its award of refunds on state law grounds.[1] As the decision makes clear, the Minnesota court viewed its decision, both as to the "meaningfulness" of the predeprivation tax court proceeding, and as to the postdeprivation relief, as dictated by *McKesson* in light of *Harper*.[2]

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[1] Respondents cite *Minneapolis Star & Tribune Co. v. Minnesota Comm'r of Revenue*, 332 N.W.2d 914 (Minn. 1983) and *Yurista v. Commissioner of Revenue*, 460 N.W.2d 24 (Minn. 1990) for the proposition that the Minnesota court has construed the refund statutes as requiring refunds of unconstitutional taxes. Neither case addressed this issue, since no other remedy was being proposed to or considered by the court, which merely affirmed without comment the lower court's award of refunds.

[2] While the Minnesota court did state that the existence of a tax refund statute provided "further support" for its decision (Pet. App. 14), the court did not hold that the Minnesota refund statute *required* that refunds be paid. If that were the case, the court would have so held in its earliest decision in this case.

That the Minnesota court did not base its decision on state law is clearly demonstrated by the concurring opinion of Justice Page. Pet. App. 17. He would have reached the same result as the majority by basing an award of refunds solely on the refund statute. If, as respondent banks argue, the court had already so held, Justice Page would hardly have bothered to write a special concurrence stating his view as to the appropriate basis for the decision.[3]

Nor did the Minnesota Supreme Court state that it intended to go beyond minimum federal due process requirements by ordering refunds even if it was not compelled to do so. Respondents incorrectly state that the Minnesota court concluded they were entitled to refunds even if there was a predeprivation remedy available. (Resp. Br. 6). In support of this statement, respondents misleadingly quote a sentence from the decision which begins "[e]ven if there was a predeprivation remedy in 1980," but which goes on to conclude, not that the banks were entitled to a refund, as respondents imply, but that they did not know they were foreclosing their right to recover a refund by failing to file a tax court action. (Pet. App. 14-15). In fact there is no independent and adequate state law ground for the decision, which is exclusively

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[3] A holding that Minnesota law requires refunds would have required the court to overrule or distinguish its own decision in *Johnson Brothers Wholesale Liquor Co. v. Commissioner of Revenue*, 402 N.W.2d 791 (Minn. 1987). In that case, the court severed a discriminatory wine tax provision found to violate the Commerce Clause under *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), and imposed a compensating tax on the favored local wine producers. In light of the severance remedy, the court held that the plaintiff in *Johnson Brothers* was not entitled to refunds. The court cited *Johnson Brothers* with approval in support of its severance holding in its first decision in this case. Pet. App. 47.

based on the court's flawed analysis of Minnesota's predeprivation procedures in light of its reading of *McKesson* and *Harper*.[4]

II. RESPONDENT BANKS FAILED TO AVAIL THEMSELVES OF MEANINGFUL PREDEPRIVATION PROCEDURES AVAILABLE TO THEM UNDER MINNESOTA LAW.

Respondents assert that there is "absolutely no question" that the Minnesota court was correct in holding that respondent banks did not have a meaningful remedy in a predeprivation tax court proceeding. Resp. Br. 12. In doing so, respondents ignore the troubling issue raised by the Minnesota decision, which rests upon the erroneous assumption that any risk or uncertainty in state predeprivation procedures may render them inadequate to meet minimum federal due process requirements. That issue is, what type of predeprivation process is required for a state to be able to extinguish any postdeprivation obligation to refund taxes?[5]

Nothing in the statutory tax court scheme applicable to respondents in 1980 implied that the banks could not

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[4] Respondents suggest that there is no reason to defer decision on the petition because the issue of a taxpayer's reliance upon a state refund statute is not presented in *Reich v. Collins*, 437 S.E.2d 320 (Ga. 1993), *cert. granted*, 114 S. Ct. 1048 (1994) (Resp. Br. 11). Yet respondents themselves assert that they paid the taxes in question under duress because of various post-assessment penalty, lien and levy provisions in Minnesota law. (Resp. Br. at 16 n.14). The issue of duress has also been raised on similar grounds in *Reich*, further demonstrating why a decision on certiorari should be deferred until a decision in that case.

[5] Petitioners have never argued that respondents "should have litigated in the Tax Court rather than the district court" as respondents claim. Resp. Br. at 5 n.5. The argument has always been that, having failed to avail themselves of a meaningful predeprivation process, petitioners are not constitutionally entitled to refunds as a postdeprivation remedy.

have litigated their constitutional claims either in tax court or in subsequent judicial review of any tax court decision. *See* Minn. Stat. § 271.01 (1978), *et seq.* Pet. App. 99-102. The Minnesota court's decision is based on the fact that questions had been raised as to the tax court's authority to decide constitutional issues. Yet as respondents acknowledge, there was nothing new about such questions. For example, in *Dependents of Ondler v. Peace Officers Benefit Fund*, 289 N.W.2d 486, 487 n.1 (Minn. 1980), the court, reviewing the decision of an administrative tribunal, stated, "adjudication of the constitutionality of legislative enactments has generally been thought beyond the jurisdiction of administrative agencies. This court, however, has the power and affirmative duty to consider constitutional challenges to legislative enactments. . . . " (citations omitted). Whatever questions may have been raised regarding the jurisdiction of administrative tribunals, the Minnesota Supreme Court has never refused to decide constitutional issues raised on judicial review of the decisions of the tax court or other administrative bodies.

No trap was therefore laid for unwary taxpayers, as in *Brinkerhoff-Faris Trust & Sav. Co. v. Hill*, 281 U.S. 673 (1930). In that case, the Missouri Supreme Court, overruling an earlier decision that a state tax commission had no authority to grant equitable relief on constitutional claims, refused to hear the claims of a taxpayer which had bypassed the tax commission in reliance on the earlier decision. In contrast, the Minnesota Supreme Court has never refused to consider a constitutional claim raised by a taxpayer in a tax court proceeding.

Nothing in this Court's procedural due process decisions suggests that the kind of "uncertainty" involved in this case renders an otherwise comprehensive predeprivation process not meaningful. Certiorari should therefore be granted to clarify whether the due process

standard in tax cases requires the heightened degree of procedural certainty the Minnesota decision adopted.[6]

III. CERTIORARI SHOULD BE GRANTED BECAUSE THE MINNESOTA SUPREME COURT WRONGLY CONCLUDED THAT *HARPER* PREVENTED IT FROM APPLYING A STATE LAW BAR TO RECOVERY OF REFUNDS.

The Minnesota Supreme Court concluded that it was prevented by federal due process principles from applying state law procedural bars to postdeprivation refund claims. The court stated: "*If* there was a meaningful predeprivation procedure in Minnesota at the time the tax was paid, *then* we have the option of denying backward-looking relief *and state law bars to relief may come into play.*" Pet. App. 9 (emphasis added). However, no holding in *McKesson* or *Harper* suggests that lack of a meaningful predeprivation process precludes states from imposing reasonable procedural requirements on postdeprivation

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[6] Respondents downplay the efficacy of the other available predeprivation administrative appeal and declaratory judgment remedies (Resp. Br. at 14 n.13). Their arguments are flawed. In fact, the Minnesota Supreme Court has never prohibited declaratory judgment actions in facial constitutional cases. *See Baertsch v. Minnesota Dept. of Revenue*, 518 N.W.2d 21 (Minn. 1994). Nor has it ever held that the courts of this state have no jurisdiction to decide constitutional issues on review of administrative agency decisions, even if the agency itself has no authority to declare a statute unconstitutional. *Dependents of Ondler*, 289 N.W.2d at 487, clearly states otherwise. As this Court has stated, "[I]t is sufficient . . . that constitutional claims may be raised in state-court judicial review of the administrative proceeding." *Ohio Civil Rights Comm'n v. Dayton Schools*, 477 U.S. 619, 629 (1986) (citations omitted). Thus, an agency's lack of authority to "declare" statutes unconstitutional is irrelevant to the adequacy of a predeprivation process which includes judicial review of agency decisions, as Minnesota tax appeal procedures unquestionably do.

remedies. Indeed, this Court's statements in those cases are all to the contrary. In *McKesson*, the Court referred to "[a] state's freedom to impose various procedural requirements on actions for postdeprivation relief," such as the right to "enforce relatively short statutes of limitation applicable to such actions." *McKesson*, 496 U.S. at 45. *See also James B. Beam Distilling Co. v. Georgia*, 501 U.S. 529, 544 (1991) ("Nothing we say here deprives [the state] of [its] opportunity to raise procedural bars to recovery under state law").

In its first two decisions in this case, the Minnesota Supreme Court imposed, as one such bar to recovery of refunds, a state law estoppel doctrine. Pet. App. 26, 45-46. The court stated: "We think this court's estoppel holding is one such state procedural bar." Pet. App. 26.[7] Yet, in its most recent decision, the Minnesota court mistakenly concluded that after *Harper*, it could no longer deny a retroactive remedy on *any* state law theory in the absence of a meaningful predeprivation remedy. This is clearly an incorrect reading of this court's due process decisions.[8]

Respondents attempt to minimize this error by arguing that: (1) the Minnesota Supreme Court mislabeled estoppel as a procedural bar, when it is really a substantive rule; (2) by inference, the court changed its mind as to estoppel because it "affirmed the trial court without explicitly discussing the estoppel issue" (Resp. Br. 17); and (3) in any event, the court was under no *obligation* to apply estoppel, so long as minimum federal due process requirements were satisfied. These arguments merely beg

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[7] As discussed in detail in the petition at 27-29, such estoppel doctrines have frequently been applied by both state and federal courts over the years.

[8] The Minnesota court's confusion may have resulted in part from its mistaken belief that the parties had agreed that the existence of a meaningful predeprivation process is a necessary precondition to denying a retroactive remedy on any state law theory. Pet. App. 9. There was no such agreement. *See* Petition at 8 n.5.

the issue raised by the Minnesota court's incorrect holding – whether this Court's due process holding in *Harper* prevents a state from raising procedural bars to actions for refunds when its predeprivation process is uncertain. Certiorari should be granted to resolve that issue.

Whether estoppel is characterized as a "procedural" or "substantive" doctrine is irrelevant. The effect of a finding of estoppel is the same as a finding that a taxpayer has not complied with applicable statutes of limitation or repose – it bars the taxpayer from litigating certain claims. Nothing in this Court's decisions indicates that such state law doctrines as res judicata, waiver, laches or estoppel must be treated differently from statutes of limitation or repose for due process purposes. Respondents' suggestion to the contrary is specious.

Second, there is no indication that the Minnesota court decided as a matter of state law not to apply the estoppel doctrine, having twice before applied it on the same facts. The court clearly believed that it was prohibited under *Harper* from again barring recovery of refunds on estoppel or any other state law theory. Having decided that a postdeprivation remedy was required, the court merely affirmed the trial court's conclusion that the respondent banks are entitled to refunds: "We affirm the trial court's order *from the remedial phase of the trial,* including the court's conclusions as to all expense deductions at issue and the entitlement to interest." (Pet. App. 16-17) (emphasis added).[9] There was simply no reason for the Minnesota Supreme Court to discuss further the lower court's estoppel holding, in light of its conclusion

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[9] The trial court's estoppel holding (that the banks were not estopped from bringing the refund claims) was included in its order from the liability phase of the trial (Pet. App. 66), not the order from the remedial phase. The Minnesota Supreme Court's express affirmance of the trial court's refund order cannot reasonably be read as supporting an inference that it was also affirming an estoppel holding in a different order.

that, after *Harper,* it could not bar postdeprivation relief on such state law grounds as estoppel.

Finally, there is nothing in its decision that indicates the Minnesota Supreme Court intended to go beyond minimum federal due process requirements and order refunds even if it was not required to do so. Respondents' suggestion to the contrary is absurd. The Minnesota court clearly believed that it was constrained by this Court's decision in *Harper* to reconsider its earlier holding that Minnesota afforded taxpayers a meaningful predeprivation process in the form of a tax court proceeding. Having concluded that a meaningful procedure was not available because of jurisdictional uncertainties, the court further concluded that it was constrained to create in hindsight a clear and certain postdeprivation remedy, and that it could not deny such a remedy on any state law theory.

Thus, no reasonable reading of the Minnesota court's decision can lead to any conclusion but that the court was doing what it believed it was required to do under this Court's decision in *Harper.* Nowhere in its decision did the Minnesota court express any intention to provide relief beyond the demands of federal due process. Had it wished to do so, the court could easily have awarded refunds in either of its two earlier decisions in this case. It is therefore irrelevant to argue, as do respondents, that the federal constitution *allows* the State of Minnesota to refund voluntarily paid taxes. Of course it does. The question presented by the decision in this case is whether the federal constitution *requires* the states to refund such taxes. Certiorari should be granted in order to resolve that issue.

CONCLUSION

For the reasons set forth above and in the Petition for Writ of Certiorari, petitioners request that their petition be granted.

Respectfully submitted,

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